

# **Rent-seeking and Asset-Price Inflation: A Total>Returns Profile of Economic Polarization in America**

Michael Hudson and Dirk Bezemer  
With charts by Howard Reed

*“More than half of all Americans feel pressure and strain, according to the April 2019 Global Emotions Report published by Gallup. Most (55%) Americans recall feeling stressed much of the day in 2018. That’s more than in all but three countries globally. Nearly half of Americans felt worried (45%) and more than a fifth (22%) felt angry. ‘Even as their economy roared, more Americans were stressed, angry and worried last year than they have been at many points during the last decade,’ Julie Ray, a Gallup editor, wrote in the summary report.”*

*USA Today, April 26, 2019*

*“For me the relevant issue isn't what I report on the bottom line, it's what I get to keep. ... I love depreciation.”*

*Donald Trump, The Art of the Deal*

## **1. Introduction and overview: A debt-strapped era of downward mobility**

The stock market has soared to all-time highs, and the unemployment rate has fallen to a decade-low. Yet the Federal Reserve’s *Report on the Economic Well-Being of U.S. Households in 2018* reports that 39% of Americans do not have \$400 cash available for a medical or other emergency, and that a quarter of adults skipped medical care in 2018 because they could not afford it.<sup>1</sup> The latest estimates by the U.S. Government Accountability Office (GAO) report that nearly half (48 percent) of households headed by someone 55 and older lack any retirement savings or pension benefits.<sup>2</sup> Even in what the press calls an economic boom, most Americans feel stressed and many are chronically angry and worried. According to a 2015 survey by the American Psychological Association, financial worry is the “number one cause of stress in America today.”<sup>3</sup>

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<sup>1</sup> <https://www.federalreserve.gov/publications/files/2018-report-economic-well-being-us-households-201905.pdf>, p. 22 (Fig. 11).

<sup>2</sup> William E. Gibson, “Nearly Half of Americans 55+ Have No Retirement Savings or Pension Benefits,” AARP, March 28, 2019. <https://www.aarp.org/retirement/retirement-savings/info-2019/no-retirement-money-saved.html>

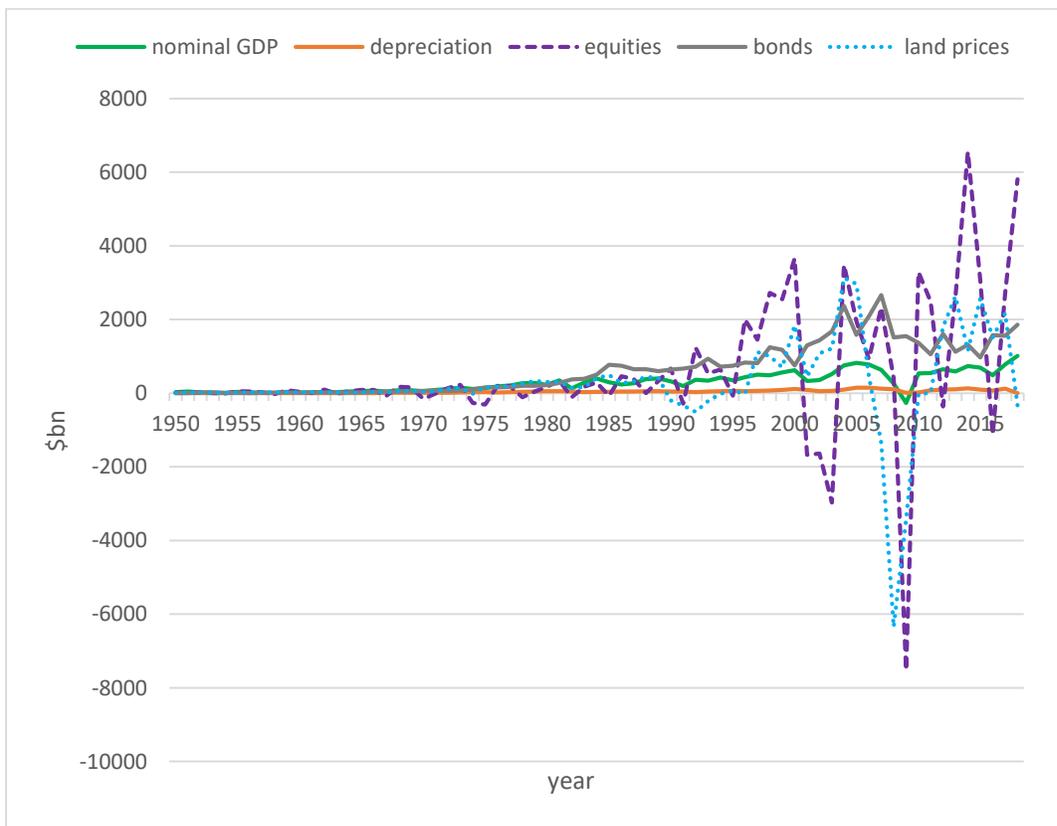
<sup>3</sup> Source: American Psychological Association (2015). “American Psychological Association survey shows money stress weighing on Americans’ Health Nationwide,” February 4, 2015.

<http://www.apa.org/news/press/releases/2015/02/money-stress.aspx>.

The Fed describes them as suffering from “financial fragility.” What is fragile is their economic status and self-worth, teetering on the brink of downward mobility. Living in today’s financialized economy creates stresses that seem more damaging emotionally than living in a poor country. America certainly is not a poor country, but its wealth and income growth are so highly concentrated that much of its population is emotionally worse off than that of almost any other country in the world.

The problem is not overall income or wealth, but the fact that the financial sector’s soaring wealth and income takes the form of a steepening liability for that of the rest of the economy. The main culprit is debt, or more specifically, the burden of having to pay it back – with penalties, fees and lower credit ratings.

Figure 1: year-on-year changes in GDP and the major components of asset price gains (nominal, \$bn)



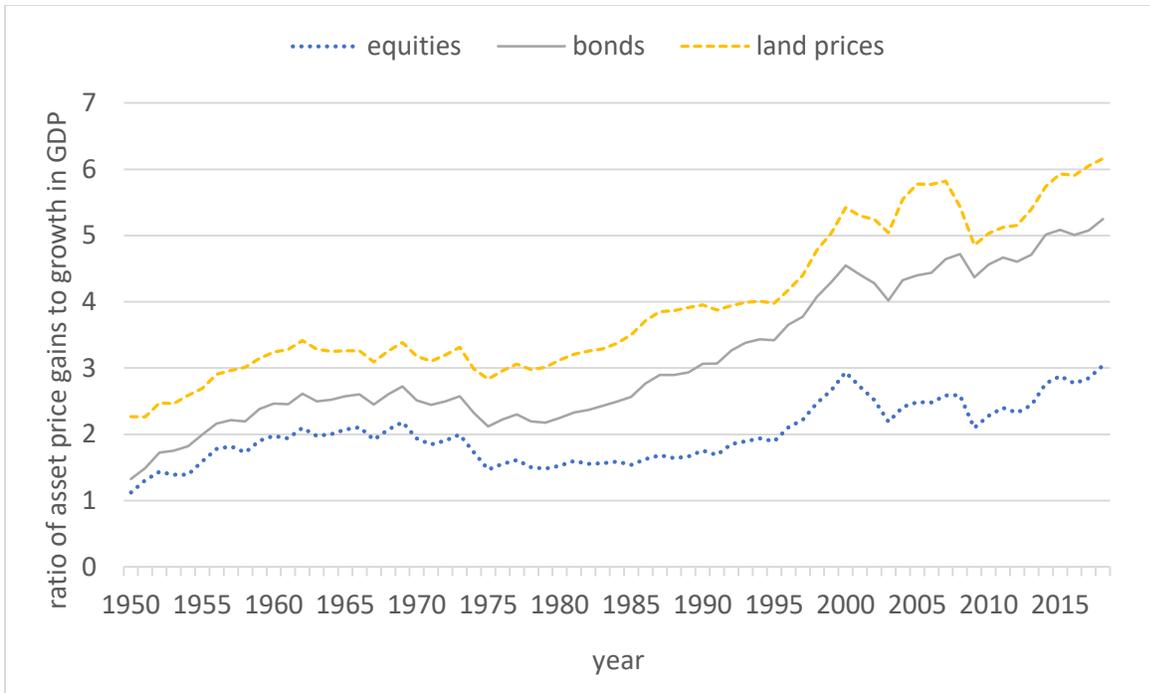
*Debt-Financed Asset-Price Inflation as Finance Capitalism’s defining dynamic*

To explain the economy’s polarization and the dangerous position in which it now stands, we show that the industrial production-and-consumption economy described in the National Income and Product Accounts (NIPA) takes a back seat to the balance-sheet

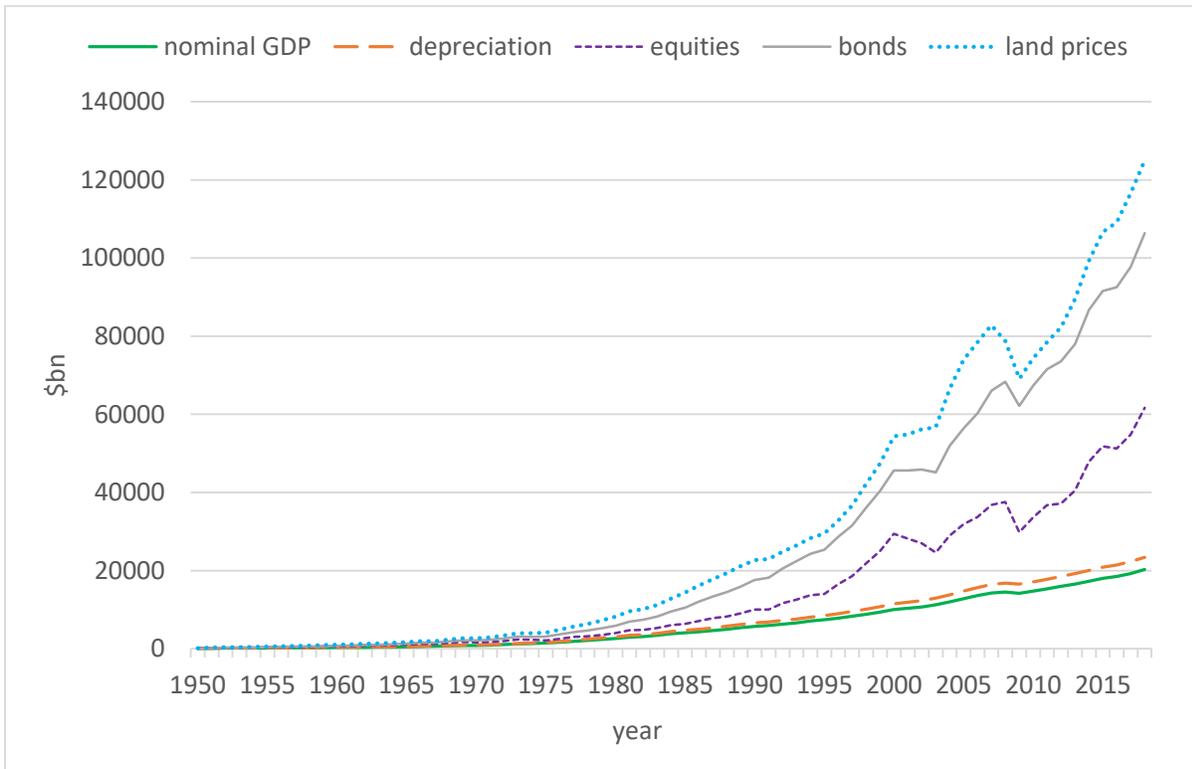
economy of wealth, borrowing and speculation. Figure 1 charts the annual change in land valuations (as reported by the Federal Reserve's Flow of Funds report), bond and stock market gains or losses compared to annual changes in GDP. In almost every year, asset-price gains in the real estate and capital markets far outpace the gains (or shrinkage) in reported GDP. And when land prices plunged in 2008 as a result of the banking system's bad loans, this caused a stock-market plunge and GDP decline.

But bond prices soared since 1980. The bond market's gains have kept pace with U.S. land-price gains, as Figure 2 shows. Financial asset prices rise as inexorably as the land prices on which classical economists focused as the key to the 19<sup>th</sup> century's *rentier* economy. Figure 2 shows that the magnitudes of bond and land price gains have double relative to GDP since the 1980s. Figure 3 shows the dollar figures: asset price gains dwarf incomes in the real economy. This financial reality of how the U.S. economy works is no longer captured in GDP statistics. That is why in this paper we will introduce a total returns measure: income plus capital gains. Studying the distribution of total returns tells us more about polarization in America than the official statistics. So the landlord class dominating wealth has now evolved into a financial class. These two charts show the extent to which finance capitalism has overtaken what was expected to be the trends of industrial capitalism.

**Figure 2: , Aset price gains as multiples of growth in GDP, 1950-2018**



**Figure 3. Cumulative total returns: the sum of GDP, equities, bonds, land values and depreciation, 1950-2018 (nominal, \$bn)**



The magnitude of “total returns” as compared to GDP, and their concentration at the hands of the wealthiest 10 Percent, has become the distinguishing feature of today’s finance capitalism: Rising asset valuations go hand in hand with the economy’s increasing focus on extraction of economic rent (discussed below). This is the opposite of what classical free market reformers hoped would be (and indeed, what seemed to be) the political dynamic of industrial capitalism in the 19<sup>th</sup> century. We explain the rising role of *rentier* income by isolating this rent, above all in the Finance, Insurance and Real Estate (FIRE) sector.

The creation and trading of property and financial assets at rising prices has been fueled by rising debt levels owed to the financial sector. This sector’s returns therefore are best seen not as real wealth on the asset side of the balance sheet, but as overhead on the liabilities side. And the process is multi-layered: income accruing to the financial wealth owned by the top 10 Percent is paid mainly by the bottom 90 percent in the form of rising debt service and other returns to financial and other property.

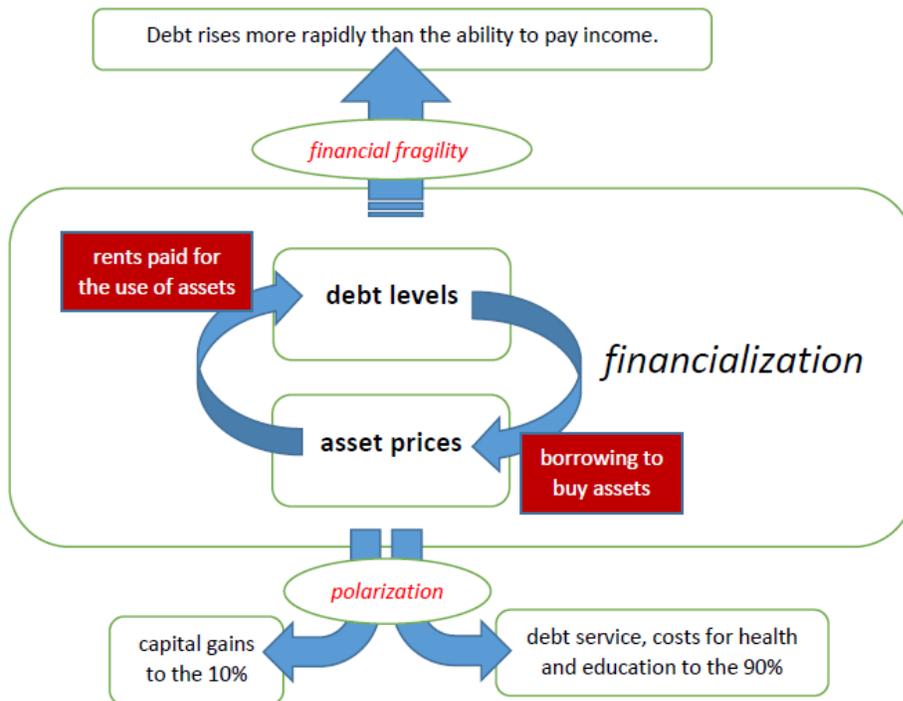
In the textbook models of industrial capitalism’s mass production and consumption, an asset’s price is determined by its cost of production. If the price rises above this level, competitors will offer it cheaper. But in the financialized economy an asset’s price is determined by how much credit buyers can borrow to buy it, not by its cost of production. A home is worth as much as a bank will lend to a bidder.

The engine of industrial capitalism and its consumer society was a positive feedback loop in which widely shared income growth, expanding consumption and markets generated yet more investment and growth. By contrast, the feedback loop of financial capitalism is an exponential growth of debt, driving up asset prices and hence requiring yet more borrowing to buy homes, retirement income and other assets. Corporate management and investment today is mainly about obtaining capital gains for real estate, stocks and bonds than about earning income.

We illustrate this by charting the flow of income and capital gains in the real estate sector to show the dominance of asset-price gains over net rental income – and how rent is for paying interest in our financialized economy. Likewise, corporate income is spent (and new debt taken on) largely for stock buybacks to raise share prices. The resulting dynamic is exponential and destabilizing.

Our conceptual framework to chart the course of today’s financial capitalism shows that the magnitude of changes in asset values and debt levels far overshadows the National income and Product Accounts (NIPA) framework that provided the statistics for industrial capitalism’s production and real investment. The drive to make wealth purely by balance-sheet asset values and rent extraction eats into the circular flow of production and consumption. That has two consequences, indicated in red in Figure 3.

**Figure 4: Financialization in America: two consequences**



The first dynamic at work is the tendency for the volume of debt to increase faster than income. This increases financial fragility as debt/income ratios rise in order to keep up with debt-inflated asset prices. That makes today’s financialized growth model unsustainable, because in the end many debts cannot be paid. *Trying* to pay them leaves less and less disposable personal income available to spend on goods and services.

We thus face a stark choice: either debt write-downs followed by renewed and more equitable income growth; or continuing wealth concentration, accelerating debt growth, widespread foreclosures and another crash. This choice can be postponed, but it cannot be avoided. And the longer a debt writedown is postponed, the more the economy will slow down and the more massive and painful the ultimate crisis must be. As long as the

debt overhead continues to grow, it will produce pathologies in the economy and in society.

The second dynamic of financialized capitalism is to polarize the economy between creditors and asset-owners at the top, and debtors at the bottom. The primary aim of today's commercial and central banking, especially since 2008, has been to fuel capital gains by more credit/debt creation. The post-2008 financial wave has created unprecedented new fortunes for the 10 Percent, but this *rentier* 'growth' model is destabilizing the rest of the economy, not enriching it. Since the 2007 crisis this dynamic has produced capital gains for the richest 10% of Americans, but is eating into the disposable spendable incomes of the bottom 90%. The Obama "hope and change" program turned out to be for Wall Street, not the rest of the economy. By keeping the existing debts in place instead of writing them down, and by deeming the largest Wall Street institutions "banks" classified as "Too Big to Fail/Jail" (TBTF/J), the U.S. economy was sacrificed to the political system's largest campaign contributors (the Donor Class).

Before being able to buy the products that they produce, wage-earners must use their after-tax income to pay for housing, debt service on their credit cards and automobile or other debts, compulsory health insurance and medical care via HMOs ("Obamacare"), education and student debt, and basic utilities taken "off the top" of their paychecks each month. Most of these debt charges and economic rents are paid to the Finance, Insurance and Real Estate (FIRE) sector as debt service and fees, land rent and monopoly rent. These *rentier* charges drain income from households and firms in the "real" production-and-consumption sector to asset owners and creditors in the financial sector. Most land and housing rent ends up being paid to mortgage lenders as interest.

Falling interest rates since the 1980s (reduced to near-zero in the last decade) have kept these payments smaller than they normally would have been. Central banks in the United States and Europe have lowered rates specifically to enable the debt overhead to be carried, and hence to avoid default, and indeed to fuel what Treasury Secretary Tim Geithner called "foaming the runway" for the enormous post-2008 debt takeoff. The resulting financially engineered boom in asset prices and capital gains has enriched

bondholders and stockholders, but has left the economy dangerously vulnerable to interest-rate increases, because polarization and financial fragility are inextricably linked.

The American economy therefore has painted itself into a corner. Low interest rates have kept the bond market and banks solvent with a high tide of new corporate, personal and government debt, but much of the “real” economy is falling into arrears in the face of the wave. Home ownership rates have fallen as properties have been foreclosed by creditors and sold to new institutional investors such as Blackstone in the booming residential rental market.

Regeneration of the socio-economic system on a more equitable and sustainable basis requires that the economy break free from this policy. The first step to create support for “de-financialization” must be to create awareness of how the dynamics and character of today’s finance capitalism are polarizing the economy and making it more fragile, leaving people more insecure. Their emotional suffering is best understood in terms of the financial and macroeconomic strains that are shaping their psychological condition and making them fearful of losing their middle-class status.

**Adding balance-sheet “capital” gains to national income**To recognize that wealth is accumulated more by capital gains than by saving out of current income, we introduce a new measure: adding capital gains to “earned” income provides a measure of the economy’s *total returns*. That is what most investors aim for in today’s age of financialization. To bring out the financialized nature of capitalism, we view the who economy as if it were a financial investment.

Balance-sheet relations, headed by credit and debt leveraging as well as tax policies (untaxing income from wealth and shifting the fiscal burden at the federal, state and local levels onto labor and industry) far outweigh current earnings. That explains why corporations use their revenue for stock buybacks and dividend payouts instead of undertaking new direct investment and hiring. It also explains why real estate investors are willing to pay most of their rental income to the banks as interest on the loans they take out to buy properties. Their focus is not on net income, but on the prospect of achieving a capital gain on the sale of the property at a higher price. By analyzing the

economy from their viewpoint, we will better understand the logic that drives the system today.

We will show that much of what FIRE-sector lobbyists have persuaded national income statisticians to report as “earnings” – and corresponding “output” – is not really earned, but is more in the character of a free-lunch rake-off, or rents’. We untangle the most egregious confusions between income and transfer payments (economic rents) that are burdens on output rather than real “product.” To see how we got here, we first briefly look at the evolution of the GDP framework. This was more fitting for the age of industrial capitalism than for today’s financial capitalism.

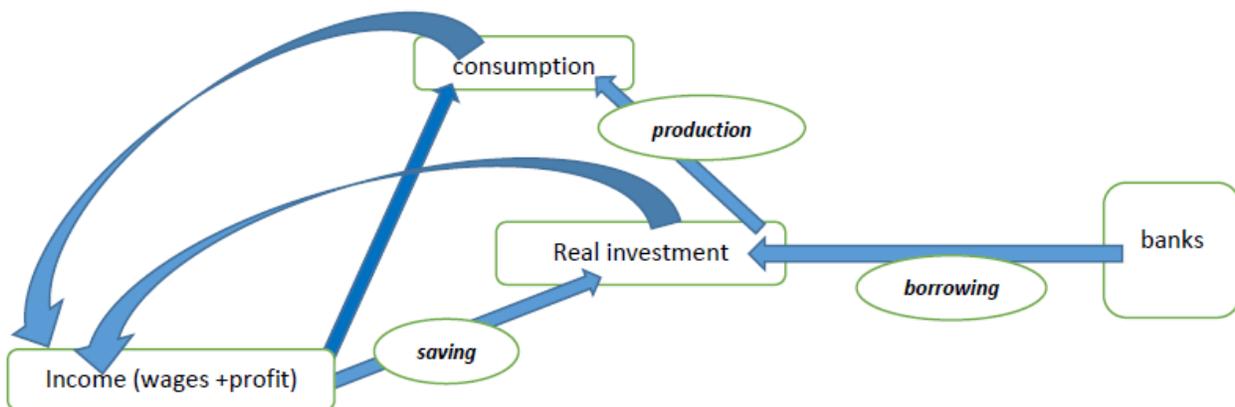
*The circular flow of production costs, consumption, saving and taxes*

Today’s basic System of National Accounts was created in the 1930s, focusing on the cost of production and how these costs – wages to labor, payments to suppliers, business profits and taxes paid to the government – are distributed and, in turn, spent on consumption, new capital investment and public programs. The resulting measure of economic activity is the Gross Domestic Product (GDP), defined as the sum of all earned incomes (wages and profit), juxtaposed to the output produced by labor and capital. This accounting format reflects a somewhat propagandistic post-classical view of how industrial capitalism is supposed to work efficiently. All returns are depicted as “earnings,” even including income not earned by work, innovation or entrepreneurship in the production process.

The original national accounting principle of circular flow can be traced back to the 18<sup>th</sup>-century French Physiocrats. Their aim was to quantify how large the economic surplus was and how it was distributed, not only among producers (labor and capital) but also to landlords, the major *rentiers* of the preindustrial epoch. The political aim was to make land rent France’s tax base, freeing labor and industry from the costs of supporting its hereditary landlord nobility whose conquest imposed land rents as a form of tribute. Adam Smith and subsequent British economists adopted this idea as the basic element of classical value and price theory so as to isolate land rent and other forms of economic rent as the ideal tax base, and to free labor and capital from high taxes and prices for food, housing and other basic needs.

By the 1930s an anti-classical revolution had taken place, asserting that all income was earned, not unearned or predatory. Meanwhile, Joseph Schumpeter's *Theory of Economic Development* expanded the view of circular flow between income and production expenditures to include banks. They were assumed to support investment and innovation by creating credit, while individual "households," partnerships and corporations invest in financial markets. In this view, production expands by mobilizing more resources and raising their productivity, enabling consumer spending to rise. Schumpeter recognized that lending also occurred for consumption and speculation, but such "unproductive lending" was outside of his focus on economic development.

**Figure 5: The circular flow of the real economy**



John Maynard Keynes and Michal Kalecki emphasized how new capital investment was dependent on rising wage income to enable consumers to buy what was being produced. Figure 2 depicts this circular flow. Its curved arrows reflect the hypothetical equality (by definition) between investment plus consumption with the wage and profit earnings that are at the heart of this model. In contrast to classical French and British political economy, their models of the industrial economy depicted all returns as incomes, taken as wages or profits. And like Schumpeter, Keynes and Kalecki emphasized how bank credit augmented the circular flow between consumption and investment. Banks were recognized only as supplying money to producers (and to consumers). On balance, they were not supposed to drain it out of the production and consumption processes. Keynes in particular recognized that this picture was incomplete and that *rentiers* undermined

the economy's circular flow. Yet despite calling for the 'euthanasia of the *rentier*,' he did not assign them a central place in his theory.

The circular-flow approach formed the basis for Simon Kuznets to develop what has become the dominant GDP model. Government spending on military and other sectors was seen to generate incomes without producing consumer goods. As military spending rose in response to World War II, its role was measured in order to focus on the disparity between income and production, so as to control inflation. His GDP framework was developed as a policy tool during World War II to keep incomes in line with the production of consumer goods.

### ***Economic rents and "capital gains" as returns beyond "earnings"***

The national accounts bequeathed to us by Kuznets and his followers misses one important aspect of financial capitalism: economic rent. That is not isolated in the NIPA's breakdown of GDP. In fact, economic rent is the blind spot of today's macroeconomics. It is a category of income and increase in wealth that does not involve work or production, but is simply the yield of a property right, legal privilege or "patent" to receive income from users of assets that are owned or patented.

Also omitted from the NIPA is a measure of how owners of rent-yielding assets benefit from "capital gains" as market prices rise for real estate, financial securities (stocks and bonds), or factories or patent rights. We put "capital gains" in quotation marks because rent-yielding assets and their asset-price gains are not capital in the sense of industrial capital – a factory, tools, R&D or other actual means of production.

Concern over rising land rent and the resulting land-price gains was central to classical economics. The quintessential *rentiers* were the landowners. It was recognized that in the normal course of things, land rents rise over time. John Stuart Mill described how a landlord enjoys such rising rents and asset-price gains "in his sleep."

The ordinary progress of a society which increases in wealth, is at all times tending to augment the incomes of landlords; to give them both a greater amount and a greater proportion of the wealth of the community, independently of any trouble or outlay incurred by themselves. They grow richer, as it were in their sleep, without working, risking, or economizing. What claim have they, on the general principle of social justice, to this

accession of riches? In what would they have been wronged if society had, from the beginning, reserved the right of taxing the spontaneous increase of rent, to the highest amount required by financial exigencies?<sup>4</sup>

If Mill had called landlords the One Percent we would immediately recognize the similarity to today's rent extraction. The One Percent, and even the Ten Percent, are the asset-owning class. They are the major designers and gainers from financialization, "without working, risking, or economizing." By imposing tollbooth monopoly charges that siphon off income from the production-and-consumption economy, their windfall *rentier* gains render the economy more polarized and fragile.

As noted above, the political attempt to free economies from such rent seeking inspired the inception of national income accounting in the mid-18<sup>th</sup> century by the Physiocrats. By measuring the economic surplus, which they saw as generated exclusively on the land, they sought to tax the post-feudal landed nobility instead of labor and industry. Francois Quesnay, a surgeon to the king of France, applied to the body politic the idea of the circular flow of blood within the human body. At the hands of Adam Smith, David Ricardo, John Stuart Mill and the reformers in their train, British political economy defined a free market as one freed from the rents siphoned off by landlords, monopolists, banks and other financial institutions from the rest of the economy, including industry and commerce as well as agriculture.

The late 20<sup>th</sup> century saw landlords and bankers fight to reverse this basic political aim of classical economics. Instead of making *rentier* income the tax base, they sought to *untax* it. To defend their anti-classical revolution, they re-defined a free market as one free *for* rent-seekers to keep for themselves land rent and monopoly rent. Bankers were given tax favoritism for investors buying rent-yielding properties on credit and paying their rent to creditors as tax-deductible interest. To defend their position, they changed the conceptual framework of national income and product accounting, rejecting the distinction between income earned in the form of wages and profits as compared to economic rent and balance-sheet gains in asset prices.

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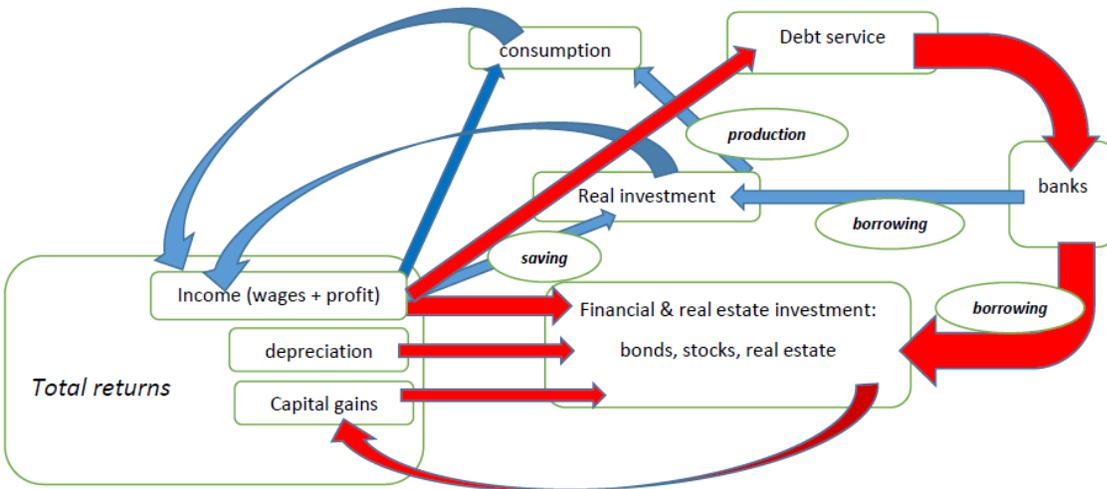
<sup>4</sup> Mill, John Stuart (1848): *Principles of Political Economy, with some of their Applications to Social Philosophy*, Book V, ch. II §5.

In reality, however, wages and profits are only two forms of revenue and the means to obtain wealth. Since the 1980s, economic rents and asset-price gains for rent-yielding assets have become the major ways in which wealth has increased, not industrial investment and earnings. Owners of property receive passive (*rentier*) income and capital gains on the rising market valuation of their real estate, stocks and bonds. But the purpose of the National Income and Product Accounts (NIPA) inspired by the circular-flow framework is not to measure asset-price gains, or to draw the classical distinction between earned and unearned income by juxtaposing wages and profits to economic rents from land ownership, monopoly privileges and patents, and finance capital.

From the United States to Europe, middle-class families have seen their net worth rise mainly because of the price of their homes, not through income saved out of their wages and salaries. The tendency is to believe that this asset-price inflation makes them and the economy richer, overlooking how it leaves the economy more debt-strapped. The vast majority of asset-price gains since the 2008 crash have accrued to the wealthiest holders of financial assets, to whom the rest of the economy is indebted.

In this way the framework of the circular flow of goods and money in the real economy has become intellectually obsolete. Financialization of real estate, stock and bond markets has created two new types of return that are not reported as “earnings”: depreciation and capital gains. Figure x shows the extent to which corporate cash flow – profit and depreciation – plus new borrowing considerably exceeds new investment, and thus has become decoupled from real investment as compared to the pre-financialization era before the 1980s and ‘90s.

***Figure 7: The FIRE sector’s intrusion into the economy’s circular flow***



MICHAEL, I BELIEVE THAT AT THIS POINT WE SHOULD USE THE FIGURE AS THE PEG TO SYSTEMATICALLY DISCUSS EACH OF THE RED ARROWS- THIS IS HOW THE SYSTEM HAS CHANGED, AND THESE ARE THE LEY ENTRY POINT TO UNDERSTAND ITS LOGIC..

- SUBTRACTIONS FROM INCOME, INCLUDING DEBT SERBVICE
- DEPRECIATION
- CAPITAL GAINS
- BANKS LENDING FOR ASSET MARKETS ( NOW AT THE END F THE PAPER)

THAT WILL MAKE IT EASIER TO FOLLOW HOW THINGS HANG TOGETHER. THIS WAS THE WHOLE POINT OF THE FIGURE.

*Should rental and financial “services” be subtracted from the NIPA as non-products?*

Landlords charge rent for their housing and commercial real estate. Homeowners keep the rising rental value of their homes for themselves. Banks create credit, enabling buyers to purchase such properties. The more they lend, the higher prices for these rent-yielding assets rise – financed on credit, with the rental value paid to the banks in exchange for loans to buy homes before rents and housing prices rise yet further.

Some rate of return is necessary to motivate investment, maintain real estate, power grids and factories, and undertake private-sector research to produce new drugs. But pharmaceutical price their drugs on which they own patents at whatever the market will bear, without reference to actual costs of production. A century ago, rates of return were publicly regulated, as were interest rates by usury laws. Rates of return for utility companies supplying gas and electricity are still regulated, but not water companies.

It was an article of faith in progressive industrial economies such as the United States and Germany that governments should prevent monopoly pricing for basic infrastructure by supplying basic needs at subsidized prices or freely: health care, water, communications, education and transportation, and also money and banking services. Progressive income taxation was to fall mainly on landlords, monopolies, banks and their owners (“coupon clippers”).

Every statistical framework is based on some implicit economic theory. Mainstream textbooks, most journal articles and policy advice euphemize all rental income as “earnings.” *Rentiers* and their lobbyists insist that all charges for access to credit, health care, education, utilities, insurance, and housing as justifiable costs for the use of bank credit-creating privileges and loans, insurance policies, real estate, drug patents, schools and power and water grids. The effect of the NIPA system of national accounts (rooted in the anti-classical reaction of J. B. Clark in the 1890s) is to leave the public with an impression that unearned rents simply do not exist – as if all non-wage income is profit, and as if everyone “earns” whatever they can take, regardless of how they obtain it.

To measure the magnitude of rent, and to build a statistical framework relevant to today’s financialized economy, we need to draw on the classical tradition by recovering the vocabulary that it developed precisely to create a conceptual framework to measure rent

extraction. Only when we statistically identify it can we analyze its role in polarizing today's economies by causing "*rentier* austerity" or "rent deflation" for the production-and-consumption economy.

Classical economists deemed legal privileges unproductive to the extent that they enable their owners to charge users of these assets more than what is needed to provide and maintain their services. They drew a clear distinction between costs of production that are economically necessary, and rent charges that are not necessary and therefore are a net burden on the rest of the economy.

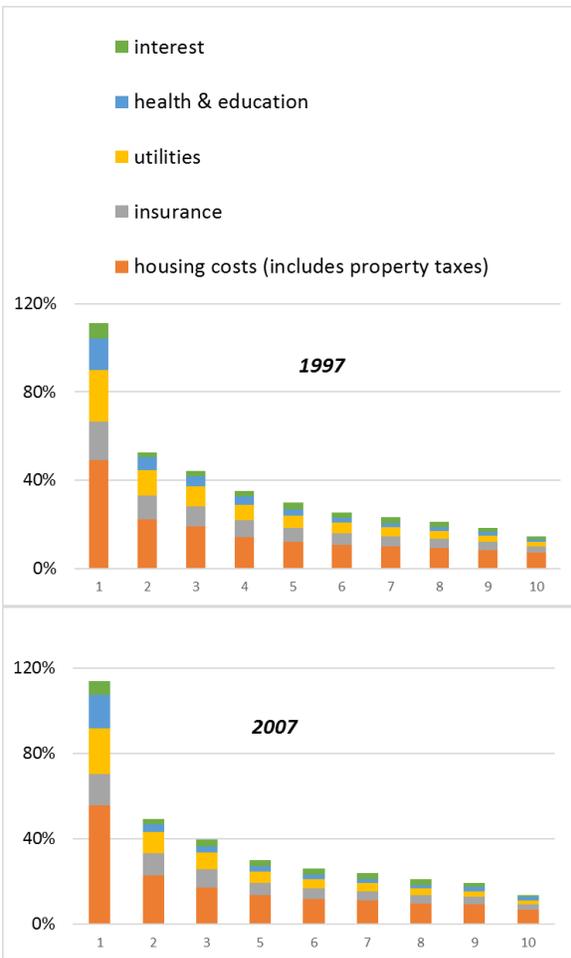
Land sites, for instance, are provided by nature, while their use-value is a product of public investment and the level of prosperity. Monopoly privileges for banks and basic infrastructure also are created by lawmakers "by the stroke of a pen." Payments to owners of these privileges, privatized and financialized into legal assets –are largely a burden on society's incomes, not an investment in the economy's capacity to generate real output. The income they redistribute as rents to the owners of these rights and privileges, are subtracted from incomes in the lower brackets of the distribution.

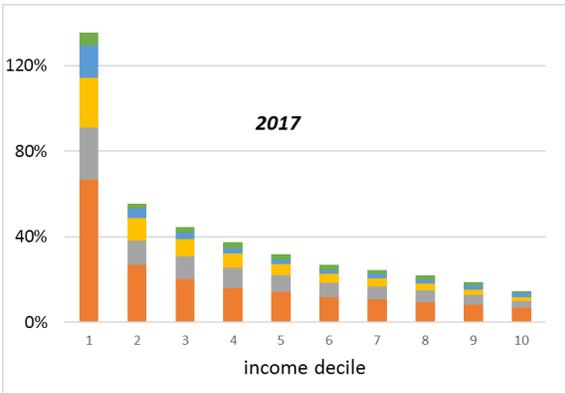
Unlike paying wages or payments for materials and professional services for production and distribution, rents are zero-sum transfer payments with no real *quid pro quo*. That is why payments for land rent, monopoly rent and financial charges should not be counted as part of the economy's "product." No value added is realized from paying such rents, so national income does not grow as a result. Such charges and fees are a pure *transfer payment* redistributing income from renters or users to *rentier* owners. They are not costs that need to be incurred in order for the productive process to continue. They are best thought of as tolls imposed at the economy's choke points, access charges independent of necessary production costs. Rents over and above these costs are paid by users as a windfall gain for *rentiers*, accruing without any productive effort of their own, as Mill and his fellow classical economists emphasized. Such rents do not reimburse the cost of investment to create these assets (land sites or exclusive patent rights), but burden the cost of living and doing business by being superimposed on the economy's production and consumption costs. Their reduction or full removal therefore will not harm production or consumption levels.

Figure 3 is our suggestion for how to measure these rents. There are numerous ways to do so, because the distinction between rent and other forms of income rests on how the distinction is drawn between returns that are productive, adding value and “product” to the economy, and returns that result simply from ownership rights and hence do not really reflect a “product” but merely detract from the economy’s income. This distinction ultimately is political, as was Kuznets’s politically expedient decision to include military expenditure as productive.

To show how regressive and extractive such *rentier* charges are, Figure 5 deducts them from after-tax incomes for each of the ten income deciles for 1997, 2007 and 2017. <sup>1</sup> In 2007, decile 4 is missing HOWARD to supply correCt figure

**Figure 7: The share of economic rents in pre-tax incomes over income deciles**





Note: These charts don't include taxes and FICA tax withholding (Social Security and Medicare deductions),. (See Distributional Chart D.1 etc. in our Appendix.)

Hardly by surprise, the lower income brackets pay the highest proportion of their income for access to housing, education and other necessities – let alone to maintain consumption. For the lowest income decile, these deductions are more than 100% of income. The poorest 10 percent receive public subsidy in addition to their reported income. Still, they are obliged to pay a higher percentage of their income as interest, especially because they are more driven to resort to usurious payday loan sharks as well as having to pay higher penalty interest rates on their credit cards.

A second noteworthy trend is that for the bottom 30 percent, total subtractions rose as a share of income *after* the 2007 crisis. And in fact, most likely these Federal Reserve figures substantially understate the housing burden for most people. Housing costs are about 15% on average for the bottom 50%. But private studies and media reports show that housing costs have risen much more than incomes, absorbing a larger and larger proportion each decade. The fact that the U.S. Government (FHA, Fannie Mae, etc.) guarantee personal home mortgages absorbing up to 43% of an applicant's income gives an idea of the proportion of income that many home buyers have to pay. The BLS, Consumer Expenditure Survey Public-Use Microdata 1996-2014 reports that households in the Lower Third spent 40% of their income on housing – and renters nearly half (as of 2014).<sup>5</sup> This suggests that something is seriously wrong with the Fed's statistics, NO

<sup>5</sup> See for instance <https://www.governing.com/gov-data/economy-finance/housing-affordability-by-city-income-rental-costs.html>, Housing Affordability Burden For U.S. Cities, and Shawn M.

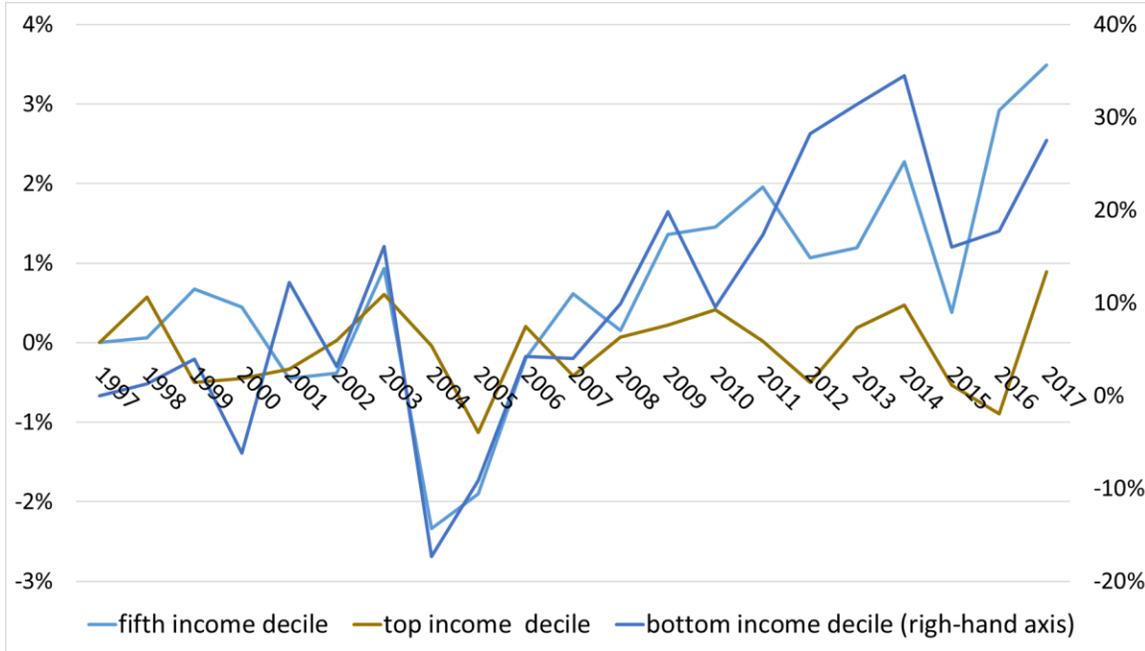
THERE WERE FALLING INTEREST RATES Given this anecdotal empirical evidence, these charts based on official statistics are only a very conservative estimate of the extent of inequality in the distribution of the burden of subtractions fomr pre-tax incomes that is due to the FIRE sector and kindred monopolies. The official statistical methodology has , by implying that the FIRE-sector deductions have barely risen as a proportion of GDP for every income decile from 1998 to 2007 to 2016, has become far removed from financial reality. This is why we need this research project to start piecing together the data that depict the true state of polarization in America.

For the moment, the official statistics are all we have, and the trends they show are already bad enough. Figure 8 shows the change in *rentier* deductions as a percentage of income over two decades. No change occurred for the top decile, but for the middle decile it rose from the mid-2000s to 3 percent in 2017 ACTUALLY I FIND IT HARD TO BELIEVE IT IS ONLY 3% - LEAVE OUT THIS FIGURE?, and at a rate *ten times* larger for the bottom decile, to 20-30 percent.

**Figure 8: Change in *rentier* deductions, as % of income:**

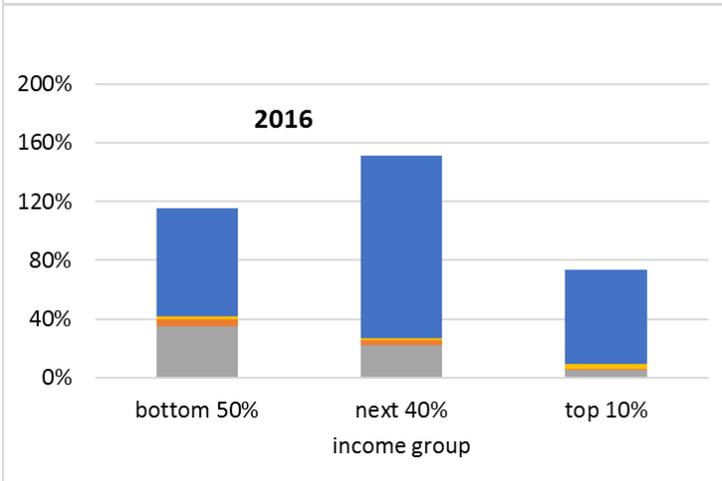
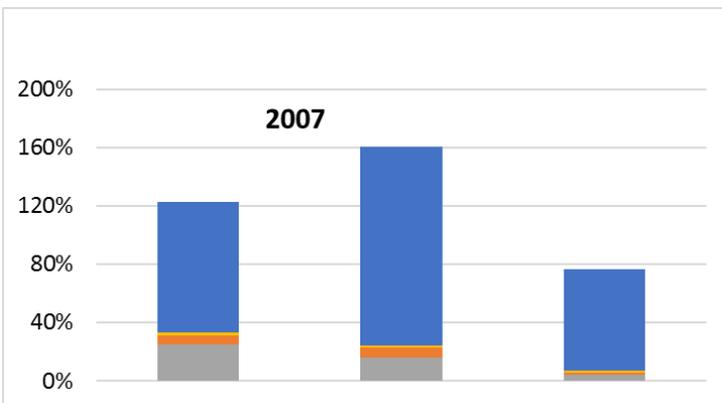
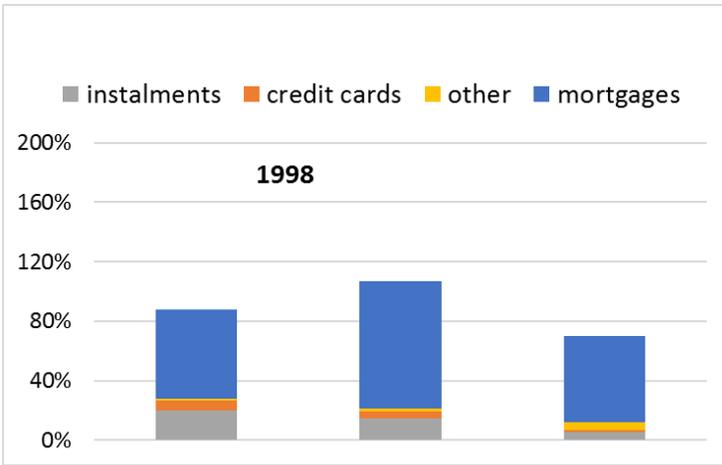
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Carter, “The top 10 US cities where rents have increased the most,” CNBC, , January 4, 2019 <https://www.cnbc.com/2019/01/04/the-top-10-us-cities-where-rents-have-increased-the-most.html>



Rising rents typically are associated with rising debt. Installment consumer loans (led by automobile loans), credit cards, student debt and home mortgages have increased massively relative to income (Figure 7). As has become the post-1980 norm DIFFICULT SENTENCE TO FOLLOW (accelerating since 2008), this trend is regressive. For the lower 50 percent of the income distribution, household debts relative to income rose by half in the decade leading up to 2007. Even for the “bottom 90” HOW DO YOU KOW? I DON T SEE THE BOTTOM 90 % - TAKE OUT? the rise in debt in those years was enormous – about a third. Only the top 10 percent saw virtually stable debt-to income ratios. Debts have fallen in the decade after the crisis (mainly because mortgage lending stopped as home ownership declined as a result of arears and foreclosures). But income growth was also negative, so that leverage has remained roughly stable.

**Figure 9: holdings of debt as percentage of income: the debt burden (% income) has risen for the 90%, but not for the 10%**



These distribution charts show that after the 2008 crisis, rental privileges remained the prime category of asset ownership. It therefore is necessary to measure the extent to which such rent-seeking is superimposed on today's post-industrial economy, eating into the circular flow of production and consumption spending.

***How financialization increases rents – and rent is for paying interest. HERE YOU START AS FROM SCRATCH EXPLAINING FINANCE CAPITALISM. WHY? I THINK THIS WHOLE SECTION CAN GO; IT REPEATS WHAT WAS ALREADY SAID***

***Does financialization contribute to economic growth, or is it a rentier overhead?***

***HAVEN'T WE ALREADY EXPLAINED THIS? THIS SECTION CAN GO.***

***Fictitious Over-Depreciation THIS SECTION SHOULD BE MOVED TO MUCH EARLIER IN THE PAPER, TO UNDER THE FINANCIALIZED-CAPITALISM GRAPH WHERE THE NEW ELEMENTS IN FINANCIALIZED CAPITALISM COMPARED TO INDUSTRIAL CAPITALISM ARE SYSTEMATICALLY DISCUSSED, ONE BY ONE. DEPRECIATION IS ONE OF THOSE NEW ELEMENTS ( THAT IS, ONE OF THE RED ARROWS IN THE FIGURE)***

Nowhere is the NIPA's divergence from reality more visible than in the treatment of depreciation, specifically for the real estate sector which the Internal Revenue Service has estimated accounts for some 80 percent of reported depreciation.<sup>6</sup> There are two sources of statistics on real estate depreciation, and each source has quite different aims. That of the IRS is to measure the actual flow IS THIS TRUE? THE DEPRECIATION REPORTED TO THE TAX MAN IS NOT AN ACTUAL FLOW OF DEPRECIATION PAYMENTS, IS IT?, of income within the economy, and to apply the tax law to this income. Over the years, lobbyists for the real estate sector and its financial backers have created a widening divergence between the picture produced by tax filings and that which the NIPA report in measuring "real" product and its income flows. The NIPA's reported picture of reality does not reflect why Donald Trump said that he loved depreciation because it enabled his accountants to show a book loss instead of taxable income. By trying to depict physical reality rather than the actual financial income flows, the NIPA statistics overlook the financial reality of how investors use various pretenses that the tax code permits absentee owners of real estate (but not homeowners) to use.

THE DERPECIATION SECTION SHOULD START WITH DEFINING IT -  
SHOULD THIS BE THE FIRST SENTENCE? Depreciation is revenue that is supposed to

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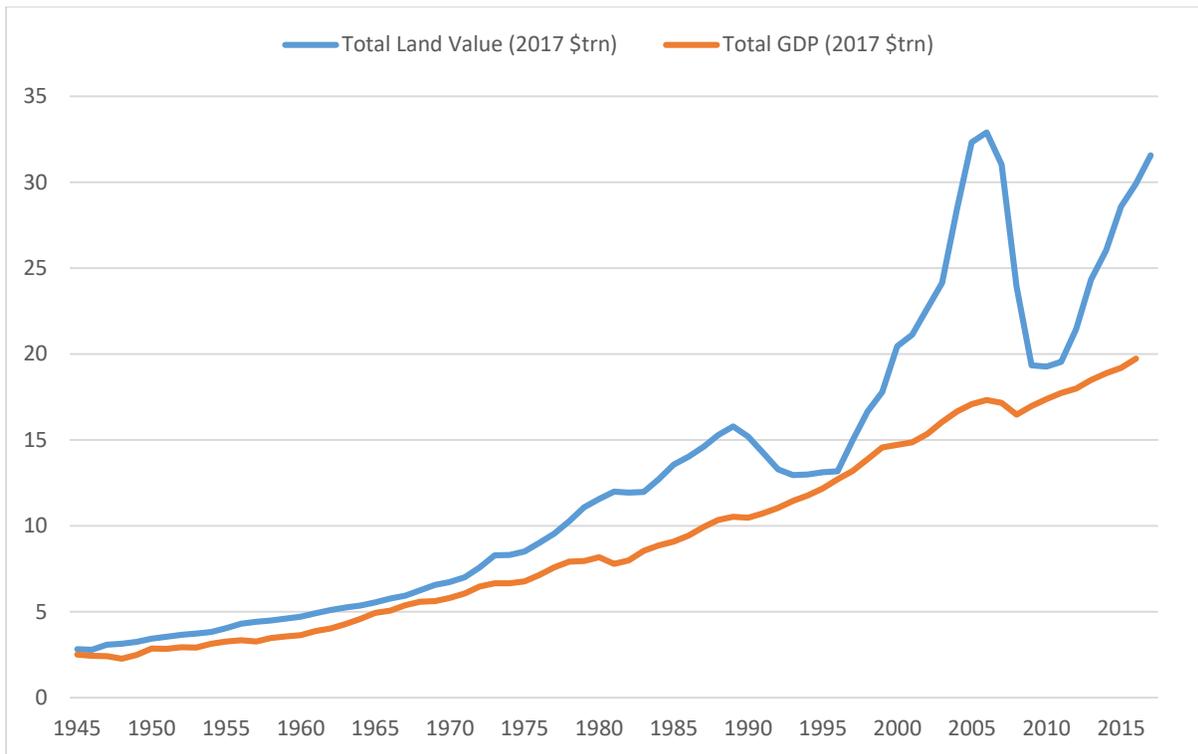
<sup>6</sup> The IRS's *Statistics on Income* is published every decade or so to provide benchmark data. That is the sole source of information on what real estate investors actually claim on their income-tax returns.

reflect the rate at which a building, factory or capital good wears out or becomes obsolete. The logic in making this revenue tax-exempt is to enable investors to recoup their original investment, as distinct from profits or rents *on* this investment. But do buildings really wear out? And if they do wear out, whether at the assumed rate of anywhere from 7 years (under the Reagan Administration's double declining balance method of calculating depreciation) or 30 years (the NIPA's "real" figure), why are so many buildings still standing that were built before 1990?

The answer, of course, is the rule of thumb that landlords typically spend about 10 percent of their rent roll on maintenance and repairs precisely to *prevent* buildings from wearing out and depreciating. But the NIPA – supported by Federal Reserve balance-sheet statistics in its quarterly Flow of Funds reports (Table Z) – show a deep confusion at work. Is it realistic for a building that has been depreciated and its value recaptured once, to be depreciated over and over again, each time at rising prices? That is what the U.S. tax code permits. Each time a real estate property is sold, assessors attribute a portion of the price gain to the building. I THINK THAT WITH A NUMBERS EXAMPE IT BECOMS ALL MUCH CLEARER- REMEMBER THE NON FINANCIALLY LITERATE PEOPLE OF TDC NEED TO FOLLOW THIS. SO LET'S SAY A BUILDING RISING FROM 100 TO 200, 300 AND 400 OVER 4 YEARS, AND WE APPLY THE REAGON DOUBLE DEPRECIATION IN 7 YEARS (14% PY), THEN THE TAX DEDUCTIONS ARE 14,28,42,56. IN THE END THE OWNER HAS HAD A TAX BREAK OF 140 ON A BUILDING THAT WOULD BE WORTH 100 WITHOUT CAPITAL GAINS. DON'T YOU THINK A SIMPLE EXAMPLE LIKE THIS AT THE START OF THE DEPRECIATION SECTION EXPLAIN WHY INVESTORS LOVE CAPITAL GAINS AND DEPRECIATION? A more realistic appraisal would be to assign this valuation to the land, not to the landlord's capital investment in the building. The effect of this mis-attribution is to enable real estate investors to take most of their net rental income in the form of tax-exempt "depreciation." *Over-depreciation* would be a more appropriate term. NIPA economists realize that the statistic they report for the real estate sector (Table 6.13D for partnerships and proprietorships, and 6.22D for corporate owners) is not the actual revenue accruing to real estate investors, but a *non-financial* imputation for how much the building "loses value" as a result of wear and tear or other depreciation (even as the

property’s price soars!).<sup>7</sup> This practice prevents a realistic estimate of how much money real estate investors actually are making tax-exempt, as Donald Trump has explained: “I appreciate depreciation. For me the relevant issue isn’t what I report on the bottom line, it’s what I get to keep.”<sup>8</sup> The fact that there seem to be no published statistics to measure this reflects the power of real estate and financial lobbyists to prevent popular awareness of just how large and egregious the false pretenses of over-depreciation really are.

Figure 10. Land Value compared to GDP Trends: 1945-2015



Despite the steady rise in land prices (FIGURE X) and hence building values, tax depreciation (and even NIPA calculations) imply that they are losing value. Real estate investors understandably do not want to publicize the extent to which their fortunes reflect these special breaks, based on fictitious assumptions favoring rent recipients at the

<sup>7</sup> The details are spelled out in [https://apps.bea.gov/iTable/index\\_FA.cfm](https://apps.bea.gov/iTable/index_FA.cfm), esp. table 3.4ESI, and explained in <https://apps.bea.gov/national/pdf/chapter13.pdf>

<sup>8</sup> Quoted in Peter J. Reilly, “Donald Trump's Deep Love Of Tax Depreciation - An Affair To Remember,” *Forbes*, October 10, 2016.

expense of the tax collector. Depreciation has become a major category of real-life ebitda – earnings before interest, taxes, depreciation and amortization.

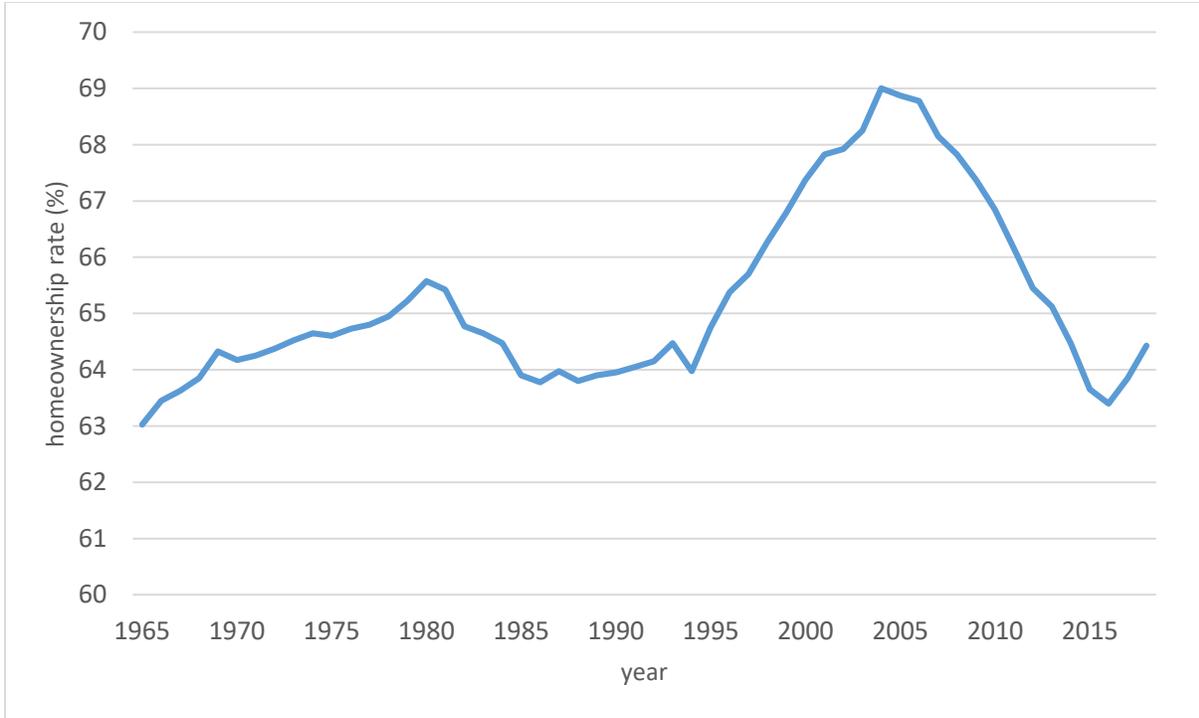
The effect of this tax “loophole” (that is, the pretense subsidized by political lobbyists) is to subsidize cash flow to fund new financial investment, helping asset prices rise. That has become the guiding logic of financial capitalism: to maximize financial flows into the real estate and financial markets. The problem for the economy at large is that this financial gain seeking drains revenue away from the circular flow of real investment and consumption instead of reinforcing it.

### *Homeowners’ imputed rental value*

In contrast to underreporting the depreciation revenue that absentee real estate investors receive tax-free, the NIPA add an estimate for “homeowners’ implicit rent.” This is a “real estate service” that does not involve any revenue at all in the economy’s actual flow of spending and receipts. It is what homeowners estimate that they would have to pay themselves if they had to rent their home instead of owning it. This estimate accounts for some 8 percent of reported GDP ([Chart 11](#))

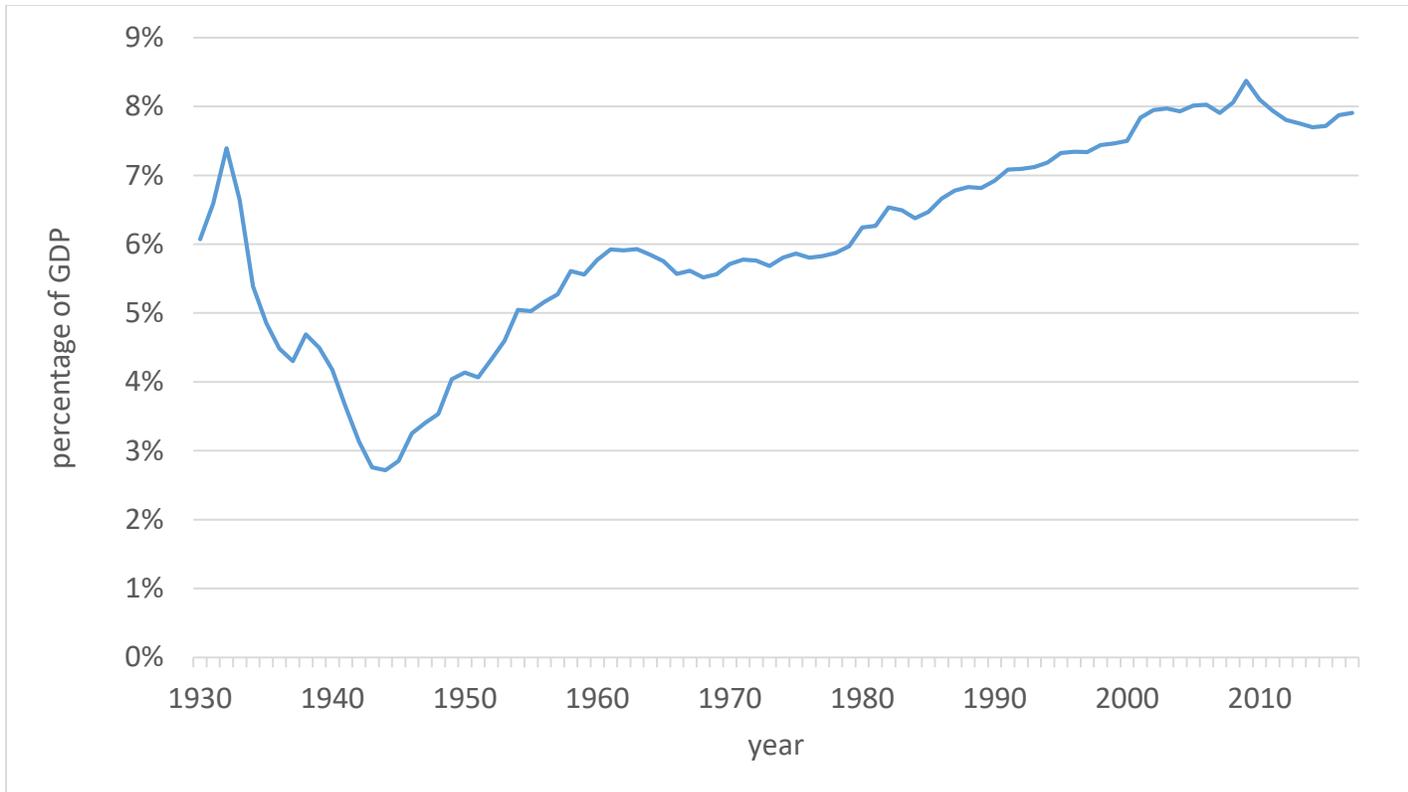
This imputed rental value does not involve any actual payment or receipt of income. Is it even really a “product”? Rents have indeed increased sharply since the post-2007 wave of home foreclosures causing a nearly 10 percent decline in U.S. home ownership rates (from 69 percent to 64 percent; [Figure 12](#)) and declines in mortgage lending and new residential construction (except for the very high end).

### **Figure 12. Homeownership rate (%)**



According to the NIPA, the combination of housing shortage, rising home prices and corresponding increase in rents (charged to the one-third of the population that does not live in their own homes) means that homeowners who would receive exactly the same living environment as before should nonetheless be credited with receiving an increased “product.”

**Figure 11. Imputed rental value of owner-occupied housing as percentage of GDP**  
**Date range: 1930-2017**



Key to data sources used:

NIPA Table 2.4.5, Line 52

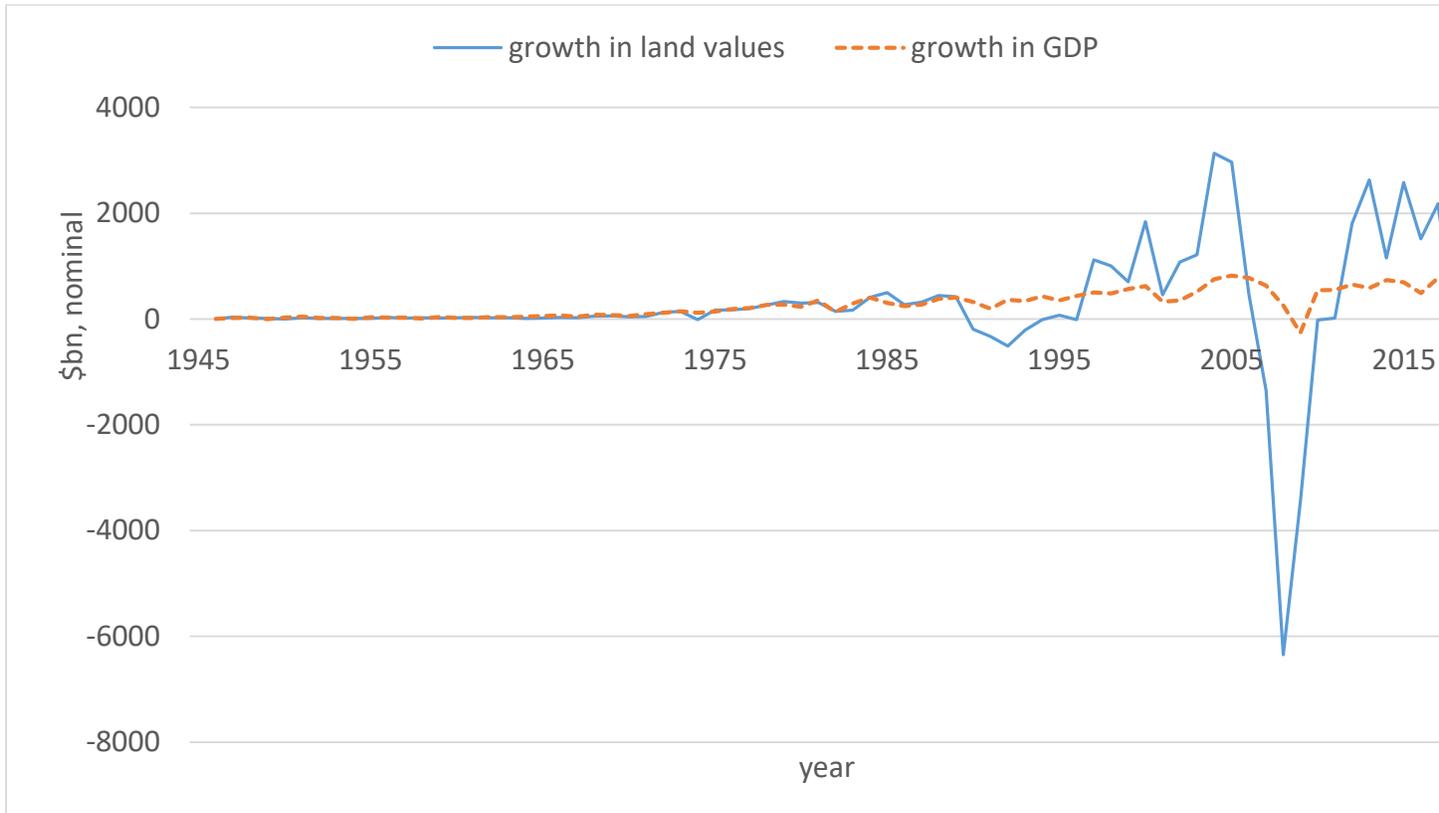
A realistic format to describe the economy would reflect how wealth is acquired increasingly by capital gains, not by saving out of profits and wages. But it is mixing “apples and oranges,” balance-sheet capital gains and the core economy of production and consumption to treat the imputed housing costs in the above chart as a “product” and hence contributing some 8 percent of (GDP).<sup>9</sup>

Lobbyists for the FIRE sector have a vested interest in wrapping a cloak of invisibility around rent extraction and wealth created by financial instead of industrial engineering. They have played a major role in shaping the NIPA to conceal the magnitude of their rents by denying the classical contrast between earned and unearned income. To avoid being taxed, the FIRE sector, monopolists and other *rentiers* seek to distract attention

<sup>9</sup> The NIPA do publish a statistic for “real GDP” by deflating each year’s reported numbers with a statistic for price inflation (the GDP deflator, based largely on a selected consumer price index to reflect the cost of living).

from how they got wealthy by shifting the fiscal burden onto productive industry without playing a productive economic role themselves.

**Figure 13. Annual land value gains compared to growth in national income – nominal, \$bn (1946-2018) WE ALREADY SHOWED LAND VALUE GINAS, WHY AGAIN??**



Key: Chart shows year-on-year change in the following variables:

Land values = sum of real estate at market value for households, nonfinancial corporate business and nonfinancial noncorporate business

(Z1 B.101 line 3 + Z1 B.103 line 3 + Z1 B.104 line 3)

Minus sum of cost of structures (Z1. B.101 lines 45+51 + Z1.B103 lines 40+41 + Z1.B104 lines 36+37)

GDP = Z1 Table F.2 line 1

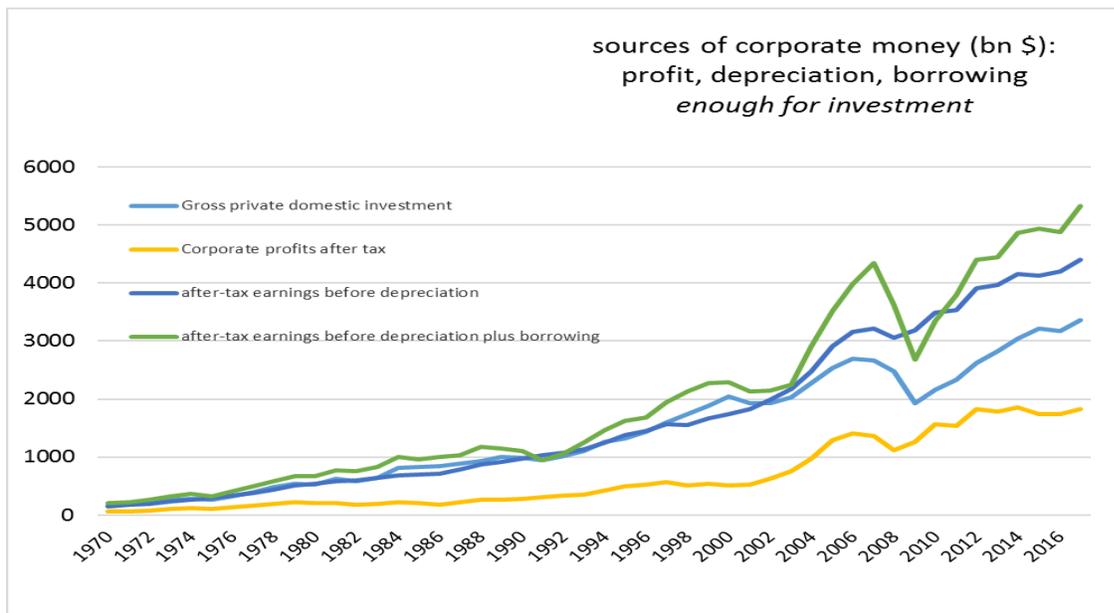
*How monopoly rents come to be treated as “product”*

REPETITION THE REPORT IS ABOUT THE U.S. NOT THE U.K. Similar *rentier* rakeoffs are characteristic of most monopolies acting as rent, such as pharmaceuticals, cable TV, Information Technology and communications, and in America, health-

insurance companies, toll roads and even parking meters in the notorious Chicago case. The effect is not to produce more or more efficiently, but simply to enrich the financial sector by sharply increasing the cost of living and doing business. Yet the profits and related financial expenses of companies are treated as contributions to GDP.

A *Financial Times* article points out the almost universal public reaction against the resulting extortionate rent grabs: “After a series of scandals and controversies over poor service, high prices and generous payouts to shareholders, the country [Britain] that was the global frontrunner in privatisation is rethinking how to manage its essential utilities. Under Jeremy Corbyn, the opposition Labour party has come out firmly for the renationalisation of rail, water, energy and the postal service.”<sup>10</sup> The aim is to increase the economy’s efficiency and lower its cost of living, yet this public “interference” with financial markets may shrink reported GDP levels. A more reasonable accounting format would exclude FIRE-sector and other *rentier* charges from the measure of “product,” but would show them s economic overhead at the *expense* of the production-and-consumption economy.

Figure 15: Borrowing was not used for investment

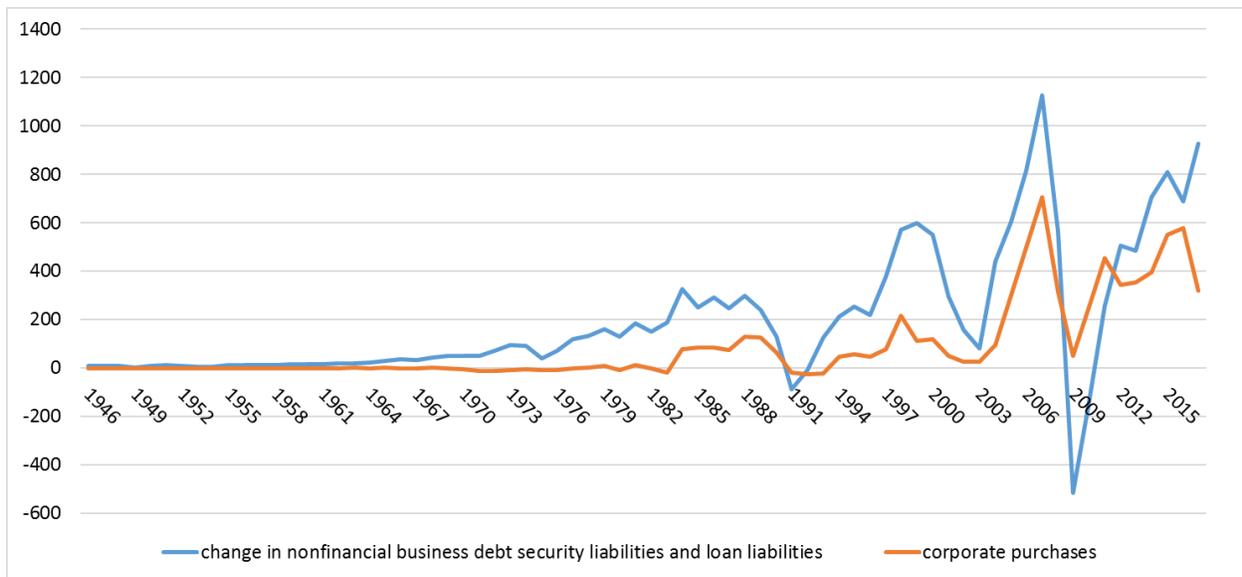


<sup>10</sup> Jonathan Ford and Gill Plimmer, “Privatization Revisted,” *Financial Times*, January 23, 2018.

The working assumption (that is, the financial cover story) is that cash flow classified as depreciation will be reinvested, replacing depleted or obsolete capital stock. But after-tax profit far exceeds the private sector’s tangible new capital formation. As noted above, the difference is explained by the fact that most cash flow is paid out as dividends or used for stock buyback programs.

After-tax earnings including depreciation almost coincided with investment until the mid-1990s, and hence was sufficient for this investment to take place. Borrowing therefore was not necessary for investment purposes. And except for a few exceptional recession years (1991, 2002 and 2009) when corporate cash flow fell so low as to be fully absorbed by investment, after-tax earnings and depreciation plus new borrowing were well in excess of real investment. Firms used this excess to pay their bond- and stock-holders, and to buy up their own stock to support its price – creating financial valuation without increasing production.

**Figure 16: Stock buybacks track debt growth since the early 1980s**



After 2002 a new financial boom started. Profits exceeded new investment by a wide margin, yet borrowing continued to rise unabated. Since 2000, its magnitude closely paralleled that of stock buyback programs (Figure x). So in view of the fact that stock buybacks have accounted for the largest part of debt growth since the late 1990s, one

could just as well say that firms use borrowing to buy back their own stocks as to say that they use their income for this purpose.<sup>11</sup>

The upshot is that net U.S. saving is only a quarter of gross saving. It used to be half. There is still plenty of gross saving, but it is not being invested in tangible capital formation. It is used to buy assets – creating capital gains in the process.

The statistical apparatus developed for industrial capitalism does not explain how the financialized aim is to increase market prices for wealth (real and financial assets) in ways external to the “real” industrial economy. To describe “total returns” beyond the categories of profits and wages, it is necessary to take capital gains into account, because they are the main aim of today’s financialized investment, and even of official policy. Taken together, bank credit, tax-free depreciation revenue, stock buyback programs and Federal Reserve Quantitative Easing have channeling liquidity into the financial and real estate markets to push up asset prices, creating capital gains for asset owners. Most of the beneficiaries are concentrated at the top of the economic pyramid, especially the top 10 percent, who recycle their gains as loans to the rest of the economy or spent on buying up more assets, with preference for those yielding economic rents.

WHAT FOLLOWS IS THE INTRODUCTION OF TOTAL RETURNS. MOVE THIS TO THE START Capital gains are today’s leading category of returns in financialized economies. To trace this distinguishing phenomenon of our era, a measure of total returns is necessary: earnings plus depreciation and interest (cash flow after taxes) plus capital gains. All these returns have been financialized, creating a new circular flow of cash flow plus debt (credit), asset price-gains, and new financial investments and asset purchases, above all to rent-yielding sectors. This financial circuit cuts in to the “real” production-and-consumption economy’s circular flow. The rising debt overhead, coupled with tax favoritism for finance, makes real investment and consumption less liquid.

The term “ebitda” is often confusing to financial outsiders. It refers to total cash flow *before* subtracting interest, taxes, depreciation and amortization writeoffs. This jargon reflects the degree to which financial analysts recognize that cash flow is much larger

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<sup>11</sup> Lescanic shows that stock buybacks and dividends absorbed 92 percent of corporate earnings in recent years.

than what the NIPA report. GDP includes accounting profit (“earnings,” including unearned economic rent) but not the depreciation that real estate owners claim on their tax returns and hence “get to keep,” in Donald Trump’s words. Depreciation is a large part of total returns in the real estate sector, where most of it is claimed in U.S. tax filings. It is rental revenue deemed tax exempt – which is why Mr. Trump loves it.

*Incorporating Total Returns into economic statistics tracing wealth disparities*

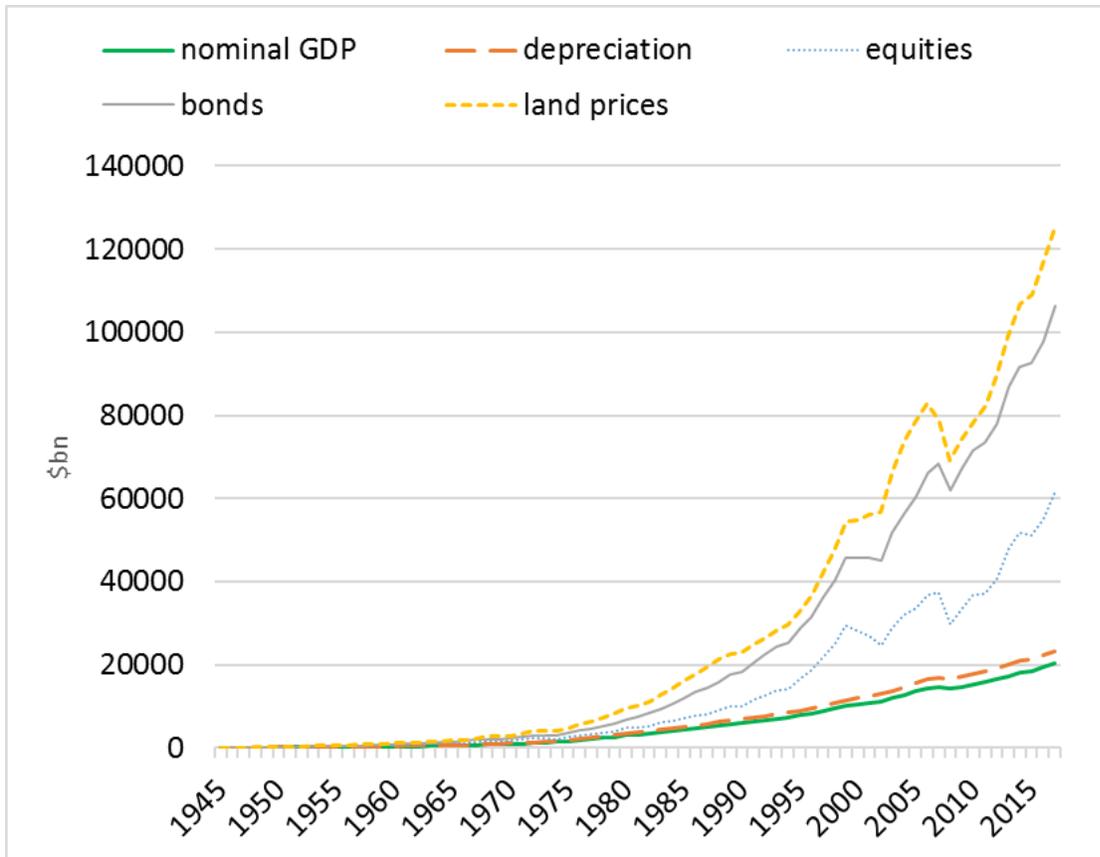
We are now in a position to integrate the preceding analysis into a macroeconomic measure to explain why financialized economies polarize and end up imposing financial and fiscal austerity. We find the standard practice of securities analysts to be appropriate: In addition to cash flow (ebitda) in the GDP “real economy” measure, we add in over-depreciation in real estate, and also capital gains so as to trace Total Returns. This is the best available measure to trace the sum of all income (GDP net of economic rent deemed to be merely a transfer payment) plus depreciation, plus price gains of the three largest assets classes: land value gains and capital gains on stocks and bonds.<sup>12</sup>

Calculating total returns allows us to do what is not possible in the GDP-based production-focused system of national accounts. Bringing together income and changes in wealth enables us to explain today’s widening disparities in the distribution of wealth and income by tracing the economy’s actual gains (or losses) (Figure 17.)

Figure 17: total returns in the US, 195-2017: GDP and year-on-year changes in equities, bonds and land values (nominal, \$bn)

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<sup>12</sup> We recognize that interest, dividends and new debt (mainly used for stock buybacks) may fall short of capital gains.

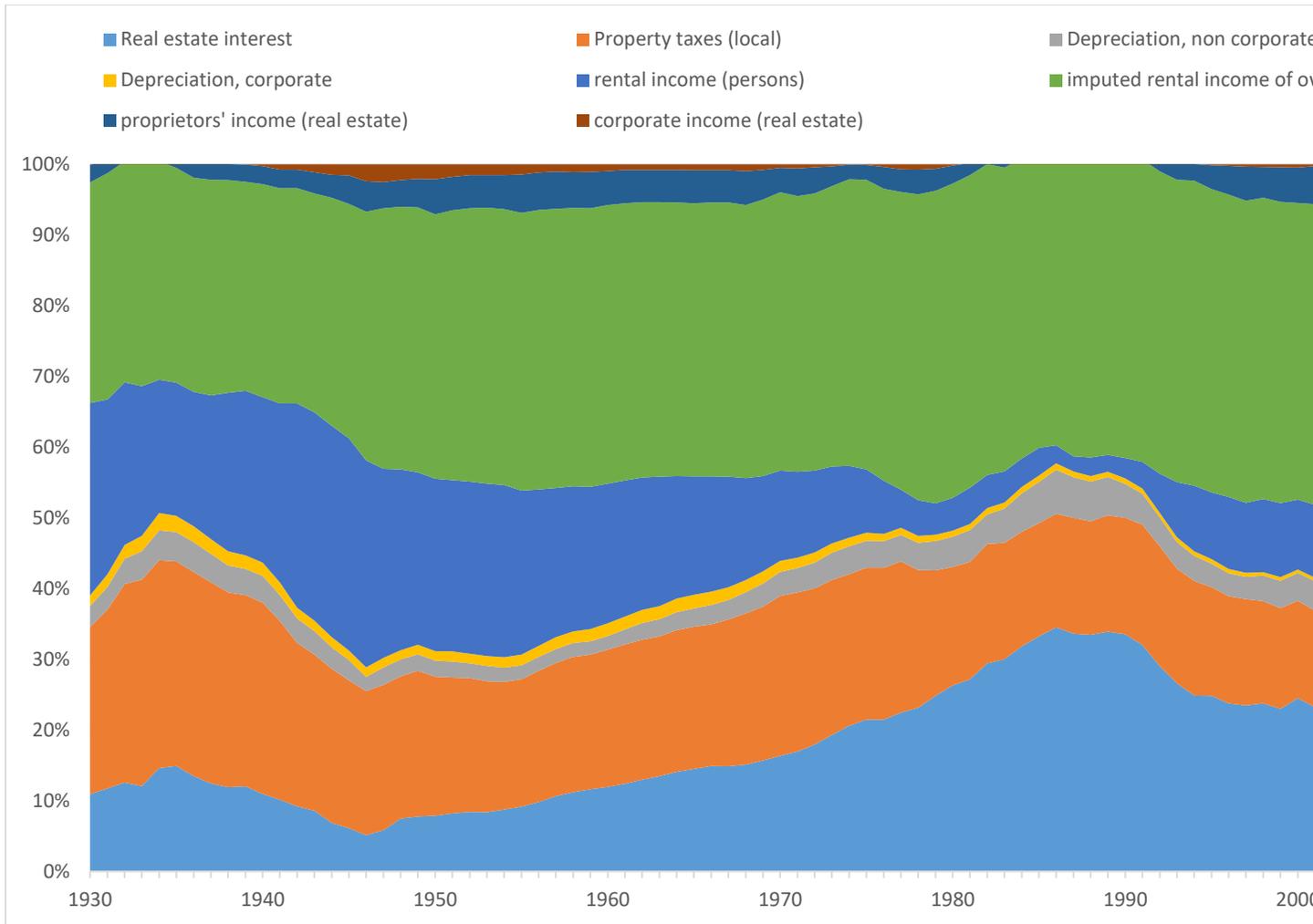


This chart shows how wealth is made much more by making capital gains on real estate, stocks and bonds than by earning wages and profits. By 1982 the annual increase in market capitalization of the bond market overtook the annual GDP in magnitude. It has risen exponentially as the Federal Reserve has driven down interest rates, increasing the capitalized value of a given income. The widening polarization of income and wealth thus has been a deliberate public policy. The Treasury has untaxed *rentier* and corporate income, showing special tax favoritism to real estate finance while the central bank has supported easy financing (with

bailouts for banks making bad or outright fraudulent loans).

Supporting these rents and capital gains, the financial sector has grown increasingly dysfunctional. The increase in capital gains has been largely debt financed. For each debt is a credit on the other side of the balance sheet. Hence, behind each borrower is a lender. The vast majority of new financial investment and bank loans are issued to acquire (that is, transfer ownership of) existing real estate assets, corporations and their stock. By driving up prices for these assets, this financial system causes home buyers to take on deeper debt levels. The effect is to divert more income to paying interest and much less for property taxes. Absentee landlords have paid scarcely any federal taxes, thanks to the tax-deductibility of what they report for interest and depreciation. (Chart 18)

**Figure 18. Composition of real estate ebitda, 1930-2015**

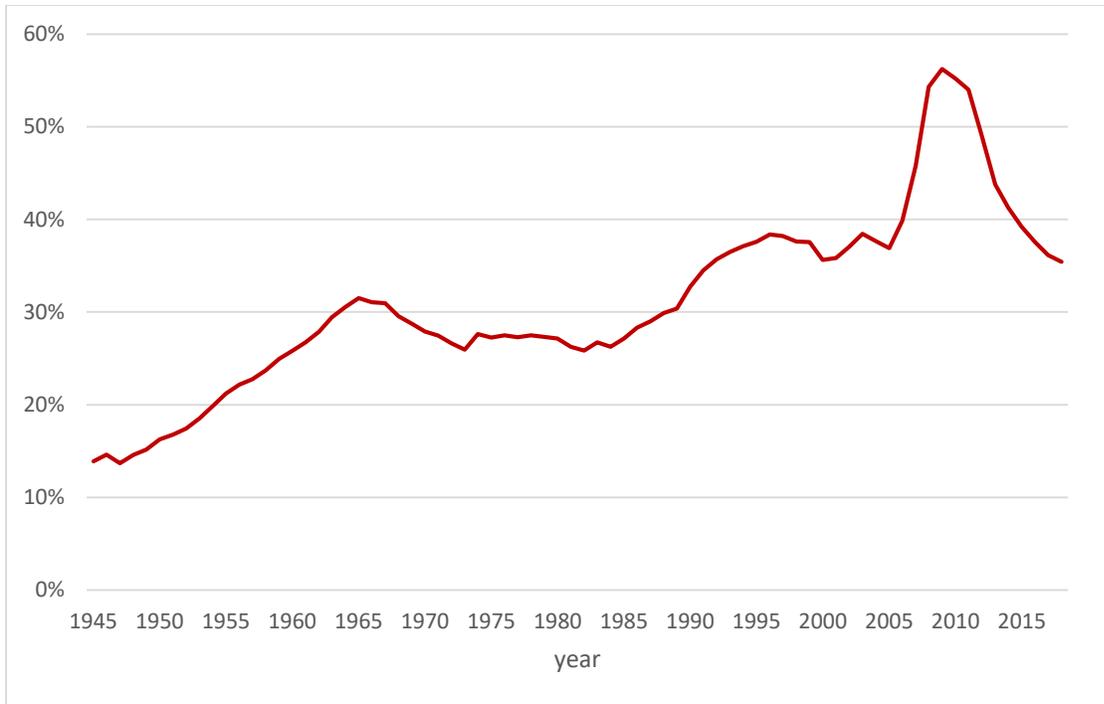


Key: Variable definitions and notes as for Figure 19

[Chart for the declining share of home owners' equity below 50 percent. Mortgage debt represents more than half of real estate valuations for the United States as a whole.]

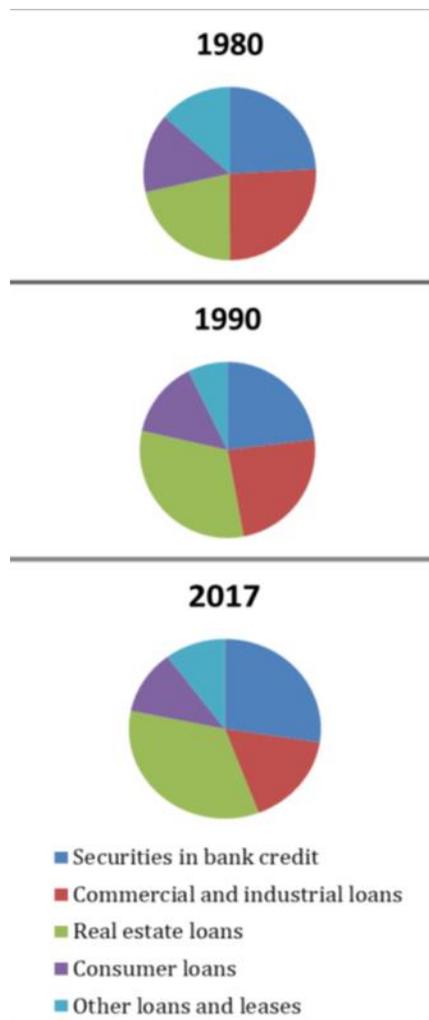
**Figure 19. Mortgage debt as percentage of residential real estate values, 1945-2018**

Polarization in America, May 30, 2019, Hudson version



This debt growth generates a flow of interest and fees that drain the economy. Most bank loans are extractive, not productive, supporting financial maneuvering to obtain capital gains and rent extraction instead of production and income growth. Tax favoritism for such loans to transfer property ownership (or for corporations, stock-buyback programs financed by borrowing) adds to the debt overhead, reducing the purchasing power available to buy goods and services and undertake new capital investment.

The pie charts below show how the share of commercial and industrial loans in all US commercial bank credit has shrunk since 1980, but especially since the 1990s. Real estate has picked up most of the slack.

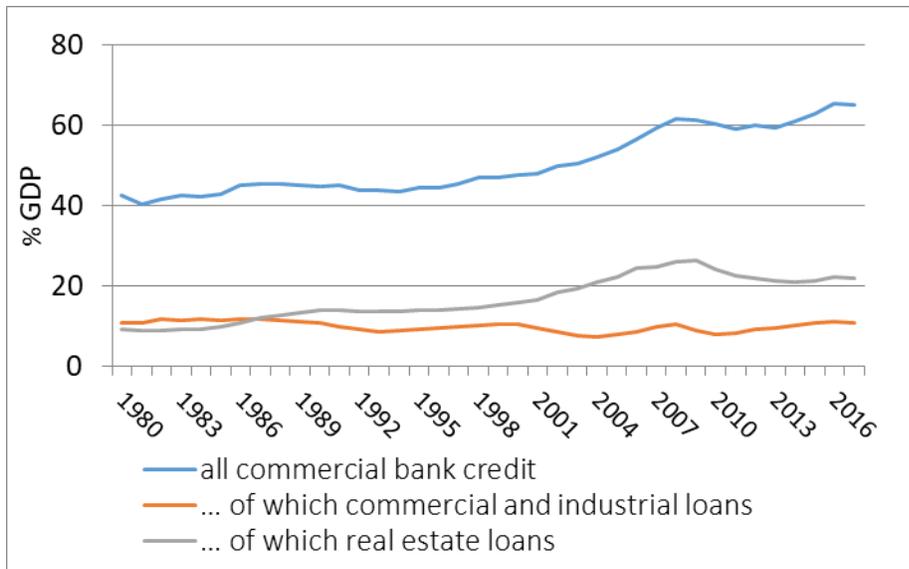


The reason why the debt/GDP and debt/income ratios have been pushed up throughout the world is that banks make little productive lending (Figure 20, A and B) shows this rise.) In the long financial expansion from the early 1990s until 2007 the debt burden owed to banks rose by more than half. This was an increase unprecedented in the entire history of US private debt. And bank loans are only a part of the total private debt burden on households and businesses.

These charts use the conventional, inflated GDP figures. The rise of the debt relative to actual net-net disposable income would be even larger and more obvious if we adjust the GDP measure exclude to the FIRE sector by measuring the rise in debt relative to actually disposable income after paying taxes and FICA wage withholding plus FIRE sector overhead).

Industrial and commercial loans stagnated while mortgage debt more than doubled relative to the GDP from 1980 to 2017.

Figure 20: Breakdown of Commercial Bank Credit as % of GDP



During the recession and deleveraging of mortgage debt that followed the 2007 crisis, debt seemed to stabilize relative to income and even to fall slightly (although it rose sharply for student loans and automobile debt). But over the last five years its growth has resumed to the point where today's magnitude of private debt is larger than a decade ago.

These financial trends show that banks do not support the economy, as bank lobbyists like to claim. Loans that are used to financially engineer capital gains instead of tangible new investment and hiring increase the debt burden without increasing the means to pay this debt. With each new real estate loan, the debt rises. But the contribution to GDP – which measures the economy's total income – does not rise. What is supported are unsustainable asset-price bubbles whose debt leveraging and tax favoritism extract purchasing power from the economy.

The mainstream narrative insists that the economy would suffer a crisis and shrink, becoming poorer if banks were forced to bear the costs of their loans going bad. It also is claimed that taxing *rentier* property rights would shrink innovation. But as Paul Volcker has quipped, the only productive financial innovation in the last generation has been the ATM machine, not the financial engineering that led to the 2008 crash and led the Fed to engage in \$4.6 trillion in Quantitative Easing bailouts of banks and FIRE-sector markets.

The Federal Reserve's \$4.6 trillion was not money creation. It was Ponzi-scheme support by means of asset swaps to increase the banking system's ability to create new credit/debt.

Forward stock trading by the Plunge Protection Team also seems to have been at work. The essence of financial engineering since 1980 has been to reduce interest rates by flooding the economy with credit that has been used to buy assets (real estate, stocks and bonds, as well to raid corporations), and rentier privileges. This has not increased the means of production or infrastructure.

Asset prices move inversely to the interest rate, as low interest rates since 1980 have enabled a given flow of economic rent or profits to be capitalized into higher prices. Governments have encouraged this way of acquiring wealth by taxing capital gains much lower (if at all) than wages and profits are taxed. The problem is that this aim of maximizing the market price of wealth – including the cost of housing and the cost of buying a retirement income – is antithetical to increasing real output and living standards. The effect is to polarize economies.

#### **4. Summary: A more realistic profile of the financialized *rentier* economy**

To provide a more realistic statistical representation of the economic dynamics creating higher valuation of wealth – and debt – in today’s economy, we provide a measure of “total returns,” defined as income plus these asset-price (“capital”) gains. And by focusing on the FIRE sector, we segregate rent-seeking sectors such as education, health insurance, and the legal profession (which rightly should be combined with the FIRE sector) as associated more with the economy’s balance sheet, property and debt relations than with production and consumption.

These figures provide the basis for a series of charts which visualize the economy’s actual dynamic, to suggest entry points for policy interventions. The logic and policy values are basically those of 19<sup>th</sup> century classical political economy, above all by distinguishing the *rentier* economy from the production-and-consumption economy so as to distinguish rent from profits.

We draw on existing statistics to show that

(1) most wealth is achieved by asset-price gains for real estate, stocks and bonds, not by saving up earnings out of wages and profits;

(2) much of what are called “earnings” are actually economic rent – revenue that landlords, monopolists and banks charge, at prices that are unrelated to the cost of production process;

(3) banks and bondholders prefer rent-yielding assets precisely because they have no inherent cost of production. Land prices reflect the rent of location, bank credit is created simply on a computer keyboard (or as it used to be phrased, “by the stroke of a pen”);

(3) prices for *rentier* assets yielding these revenues are inflated largely by bank credit, indebting the new buyers. As credit terms are “loosened” by longer maturities, lower down payments and higher limits on debt/income ratios, bank credit tends to inflate asset prices;

(4) banks and bondholders recognize that whatever the tax collector relinquishes is “free” to be to be paid as interest. An incidental political effect of rising debt/income ratios incidentally transferring property management to the financial sector in a client relationship, while endowing the FIRE sector with economic power to lobby for tax favoritism for *rentier* activities;

(5), since 2008, central bank intervention directly into the capital markets has supported the price of assets instead of permitting asset prices to fall and wipe out creditor claims and the gains they have run up;

(6) this attempt to sustain the unsustainable cannot succeed in the long run. Debts that can’t be paid, won’t be.

Economic polarization between the FIRE sector and its allied monopolies vis-à-vis the rest of the economy (labor, industry and the government) is the defining characteristic of the post-2008 period. Distinguishing the productive activities of production and consumption from economic rents shows the degree to which asset prices reflect the capitalization not only of productive capital investment but even more, *rentier* opportunities to extract land rent, monopoly rent and financial charges.

Rental payments for legal property rights are external to the necessary costs of production. Likewise in today’s financialized economy, credit and its interest charges (and inflation of asset prices) are external both to the *rentier* economy *and* to the

industrial economy. Their cost of production is minimal, but their returns are large. Most important, we show that the main effect of the financial sector is to inflate asset prices on credit, producing capital gains while increasing the economy's debt overhead. The main way to obtain capital gains today is to borrow credit to buy rent-yielding assets, and to persuade governments to untax this revenue.

There are various dynamics that national income and product accounting formats may wish to measure to track an economy's course. From the Physiocrats through Adam Smith, Mill, Alfred Marshall and other classical economists, the aim of national income accounting was to isolate income that was deemed unnecessary for production, but simply added to the economy's cost of living and doing business. Classical economics was basically the progressive reformist expression of industrial capitalism as it sought to free itself from the legacy of feudalism – land rent, monopoly rent and predatory banking. These forms of overhead were seen to leave unreformed *rentier* economies uncompetitive. The classical solution was to tax away the rent of location for land sites, and to take natural monopolies into the public domain so as to prevent monopoly rent.

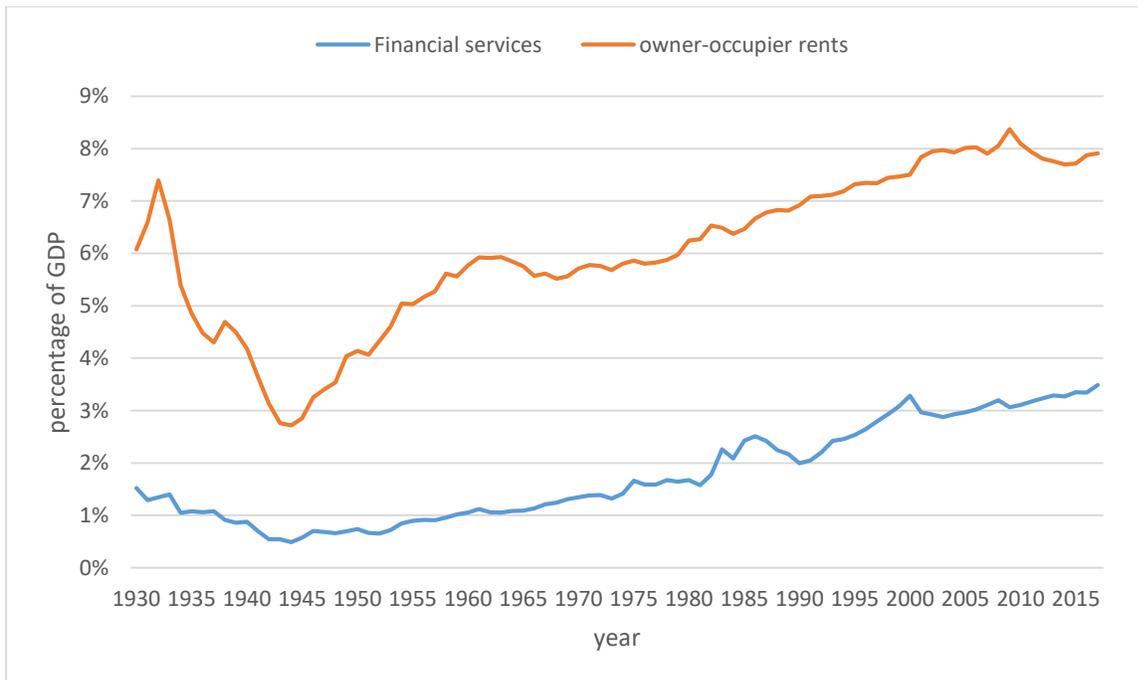
By the time the NIPA was formulated in the 1930s, an anti-classical reaction had been mounted. The *rentier* classes claimed that economic rent did not exist, and that their activities as landlords, monopolists and bankers was not a form of overhead but was necessary for industrial economies to function. The NIPA measures more than what the U.S. economy produces, and how income from this productive activity was distributed. It includes rentier income and leaves out of account the costs and returns associated with the balance sheet of property, credit and debt.

The NIPA's GDP format and its aim thus is different from classical political economy. All ways of making an income were deemed to be productive. No legal income-making activity was deemed unproductive or a form of overhead, even *rentier* activities that simply transfer income from asset-users (renters, consumers of monopoly products and debtors) to asset-owners (landlords, monopolies and the financial sector). Egregious examples include the treatment of financial services (late fees, penalties and “accrued interest”) as “product.”

The intellectual legacy of the GDP/NIPA accounting format has been distorted by including many lines that are the result of political lobbying. Our discussion of over-depreciation credits to the real estate sector shows the degree to which tax favoritism rests on economic pretense that the landlord’s rent is offset by a hypothetical physical deterioration of the building and hence a financial loss. The tax code permits absentee real estate owners (but not homeowners) to pretend that their buildings (and “capital improvements”) are losing value, despite the fact that they rise in price over time, and also include much capitalized land valuation *as if* it was part of the building. Also, “imputed rent for homeowners” pretends that as home prices are inflated on credit and rents rise (along with mortgage debt), this adds to GDP.

**Chart 21** shows two of the most egregious inclusions: imputed homeowners’ rent, and “financial services” *e.g.* in the form of penalties for late payment, speculation, etc.

**Figure 21. Imputed financial services and imputed owner-occupier rents as % of GDP**



Other critiques of the NIPA claim that it excludes an imputation for the value of housewives’ work, or an imputation for the cleanup costs of the environmental pollution being created by the way in which GDP is achieved. These are all valid perspectives, but our critique emphasizes the

need to track the actual income and financial flows involved in the economy's transactions. We thus favor excluding imputation in order to trace how economic gains are made, who receives them, and whether they are obtained by actively contributing to production or passively as *rentier* income and asset-price gains.

What has occurred is an inversion of values about the proper aim of economies. It is to get rich by means of a financialized *rentier* economy. From the point of view of *rentiers* and other investors, the production-and-consumption economy is the overhead. The costs of labor and capital are to be minimized by squeezing out more economic rent. Our approach treats the production-and-consumption sector as primary, and the FIRE sector and other rent extracting sectors as overhead.

Footnotes to add:

We should add that other critiques of the NIPA claim that it excludes an imputation for the value of housewives' work, or an imputation for the cleanup costs of the environmental pollution being created by the *way* in which GDP is achieved.

These are all valid perspectives, but our critique emphasizes the need to track the actual income and financial flows involved in the economy's transactions. We thus favor excluding imputation.

My Patten article (public infrastructure)

My models: Killing the Host and The Bubble and Beyond

My history of classical economics and simple model: J is for Junk Economics

My critique of GDP treatment of imports, exports and the balance of payments to measure "real" flows, not actual payments flows.

Our joint articles

we may want to calculate ratios for these total returns relative to (1) reported GDP, and (2) our measure of GDP – the FIRE Sector.

## LIST OF CHARTS

Figure 1: year-on-year changes in GDP and the major components of asset price gains (nominal, \$bn)

Figure 2: Multiples of equities + bonds + land prices, cumulative, to growth in GDP 1950-2018

Figure 3. Total returns (summed each year): GDP, equities, bonds, land values and depreciation, 1950-2018 (nominal, \$bn)

Figure 4. GDP and asset valuations – cumulative change since 1950 (nominal, \$bn)

Figure 5: Financialization in America: two consequences

Figure 6: The circular flow of the real economy

Figure 7: The “nut” taking priority out of consumer paychecks (percentage)

Figure 8: Change in rentier deductions, as % of income:

Figure 9: holdings of debt as percentage of income: the debt burden (% income) has risen for the 90%, but not for the 10%

Figure 10. Land Value compared to GDP Trends: 1945-2015

Figure 11. Imputed rental value of owner-occupied housing as percentage of GDP

Date range: 1930-2017

Figure 12. Homeownership rate (%)

Figure 13. Annual land value gains compared to growth in national income – nominal, \$bn (1946-2018)

Figure 14: The FIRE sector’s intrusion into the economy’s circular flow

Figure 15: Borrowing was not used for investment

Figure 16: Stock buybacks track debt growth since the early 1980s

Figure 17: total returns in the US, 195-2017: GDP and year-on-year changes in equities, bonds and land values (nominal, \$bn)

Figure 18. Composition of real estate ebitda, 1930-2015

Figure 19. Mortgage debt as percentage of residential real estate values, 1945-2018

Figure 20, A and B: Breakdown of Commercial Bank Credit as % of GDP

Figure 21. Imputed financial services and imputed owner-occupier rents as % of GDP

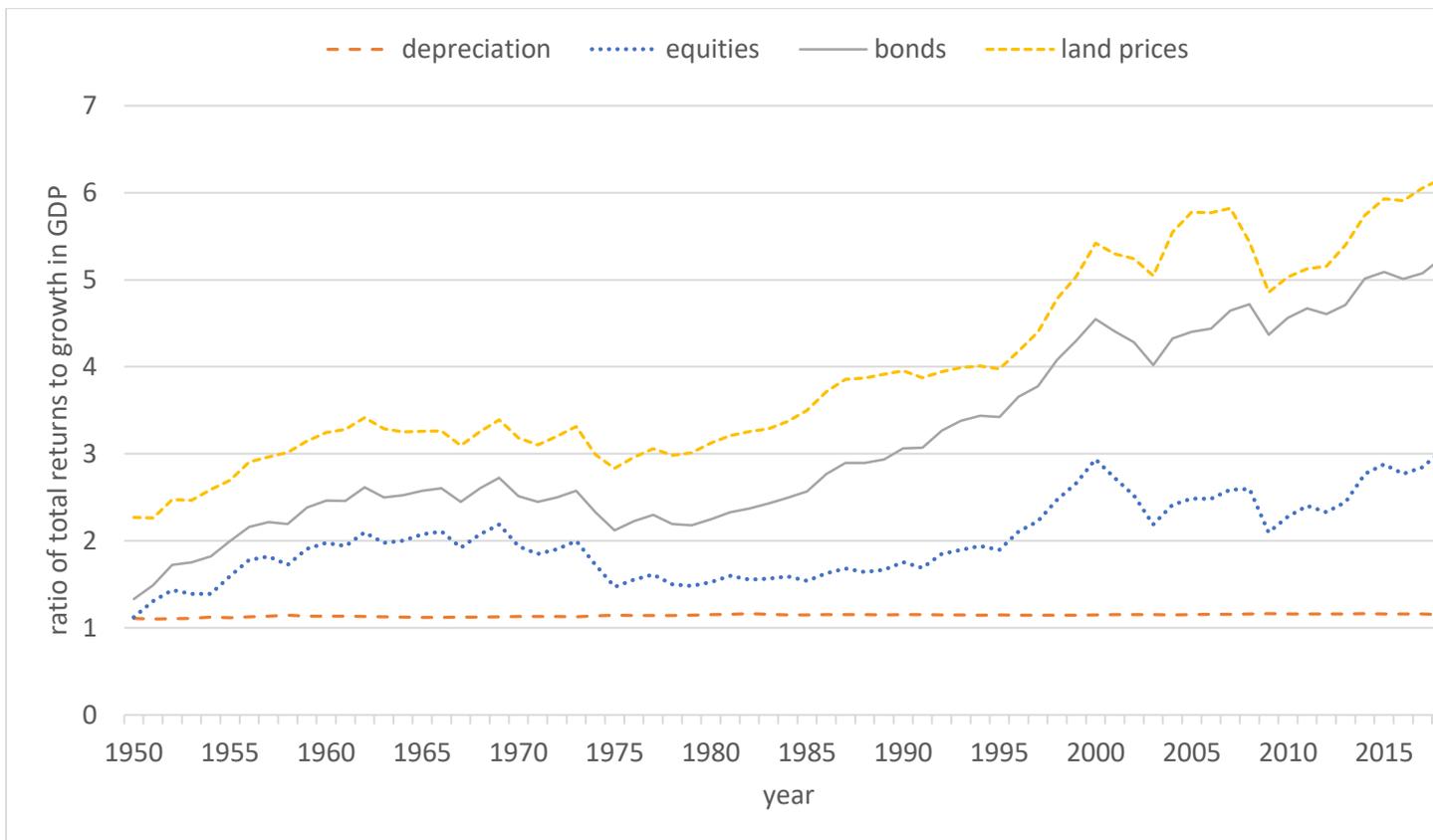
Dear Howard,

We define “capital gains” as the ANNUAL CHANGE in the value of assets – real estate, stocks and bonds. It looks like your chart has TOTAL value, cumulative.

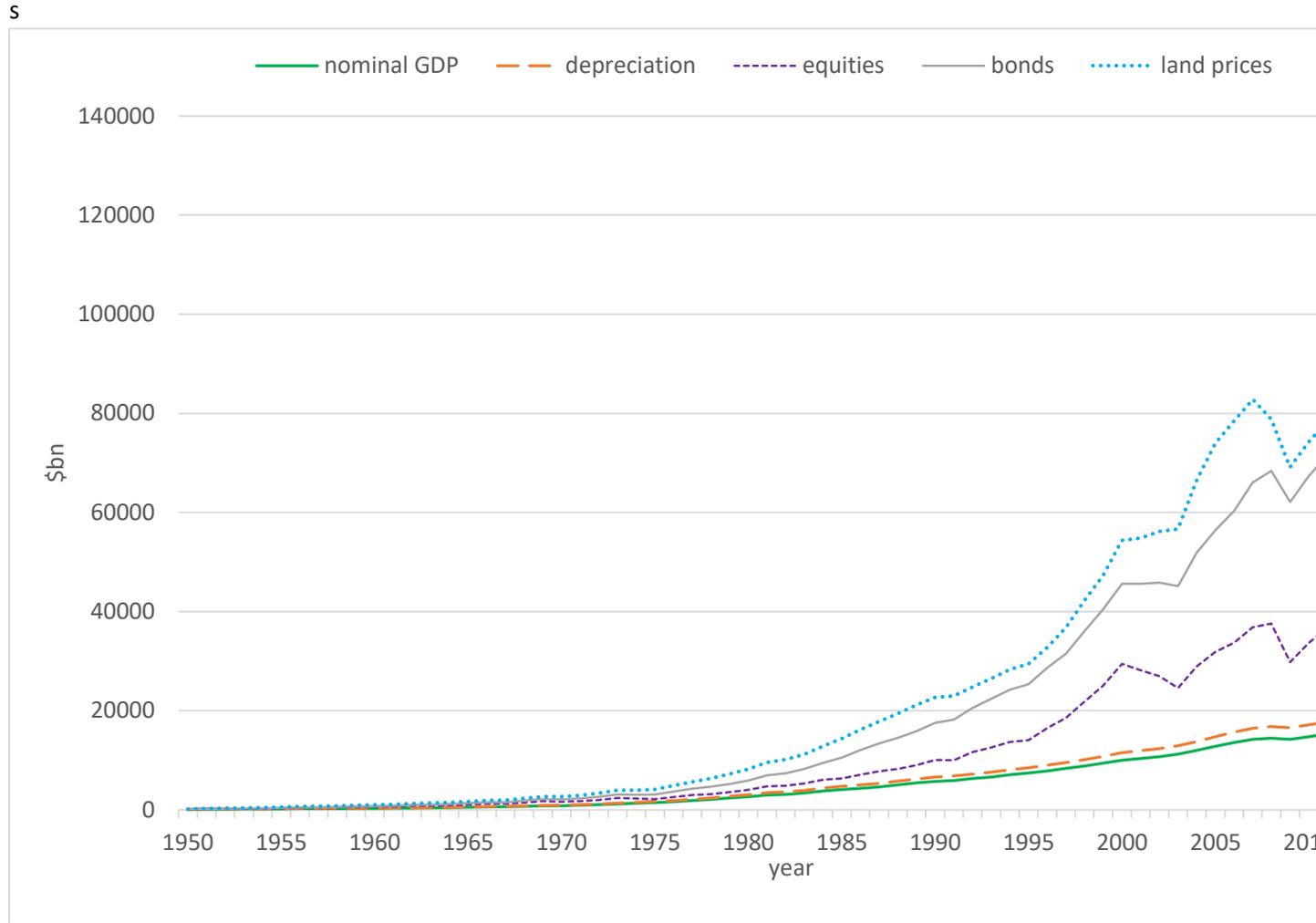
Can you make the charts show the CHANGE in asset valuations?

We also might make a PRICE INDEX of the cumulative changes, compared to 1980 as a base year. This would take the figures in your chart as it already exists.

**Figure 22. Ratio of total returns to growth in GDP (depreciation + equities + bonds + land prices), 1950-2018**



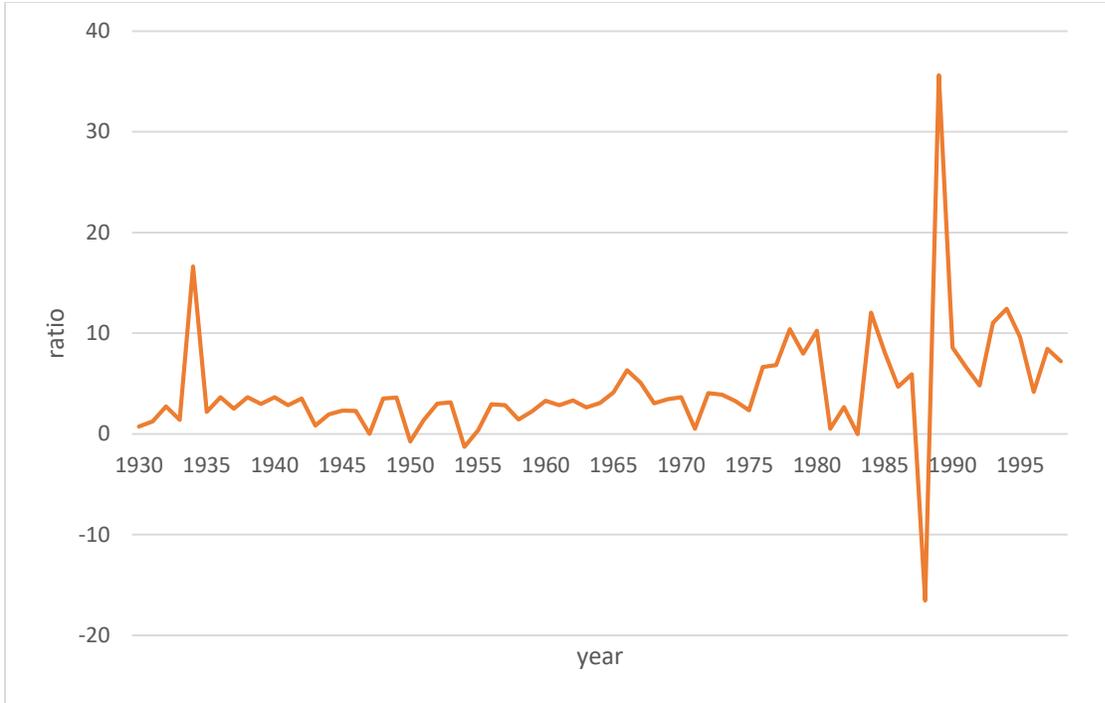
**Figure 23. Total returns (summed each year): GDP, equities, bonds, land values and depreciation, 1950-2018 (nominal, \$bn)**



**Figure 24. Total capital gains (depreciation + equities + bonds + land prices) as ratio of GDP growth, year-on-year**

This is change in asset prices divided by GDP growth each year – trending upwards, but volatile

Polarization in America, May 30, 2019, Hudson version

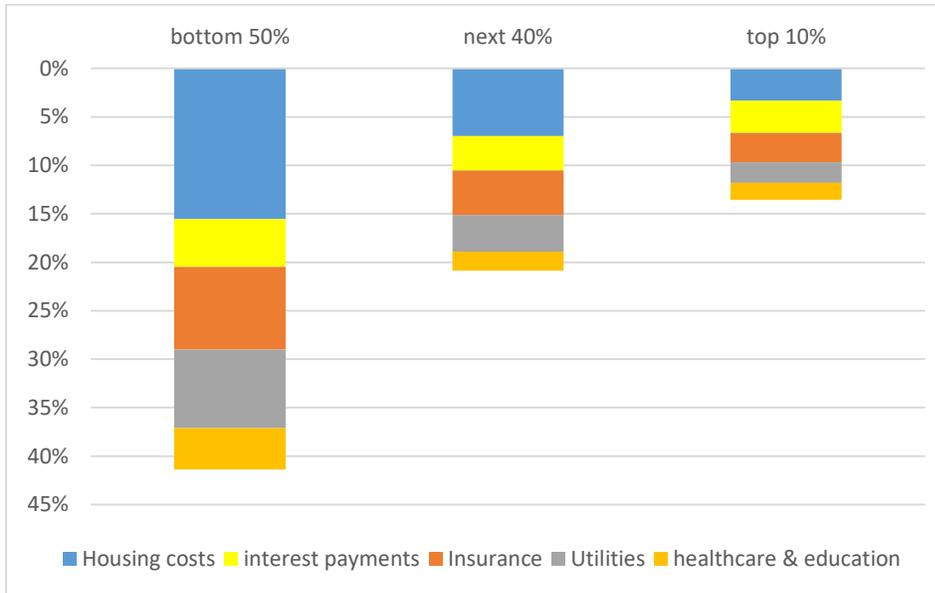


Appendix Charts

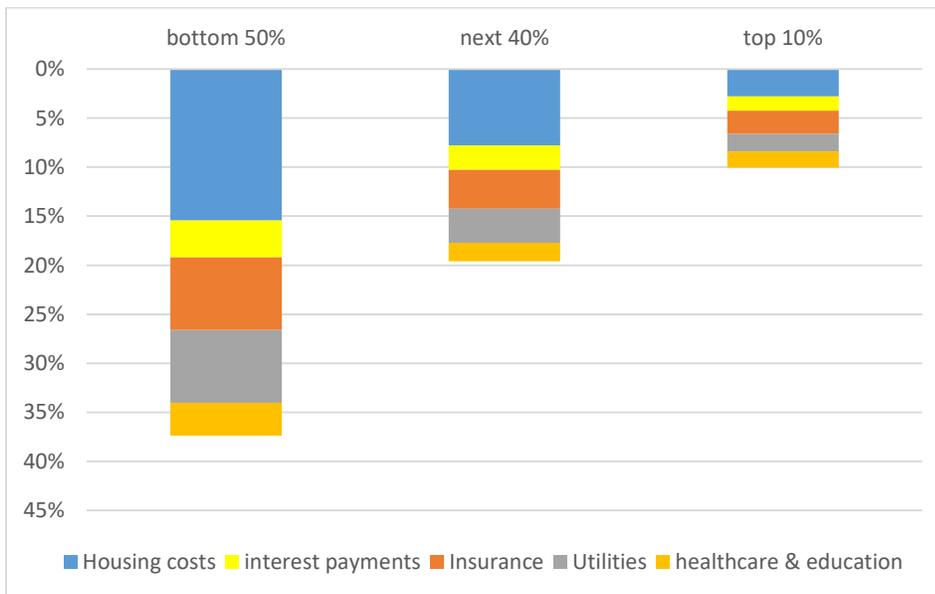
Distributional charts

**Figure D.1: Deductions from gross income as a proportion of gross income, for households in bottom half of income distribution, the next 40% (deciles 6-9) and the top 10% (top decile): 1998, 2007 and 2016**

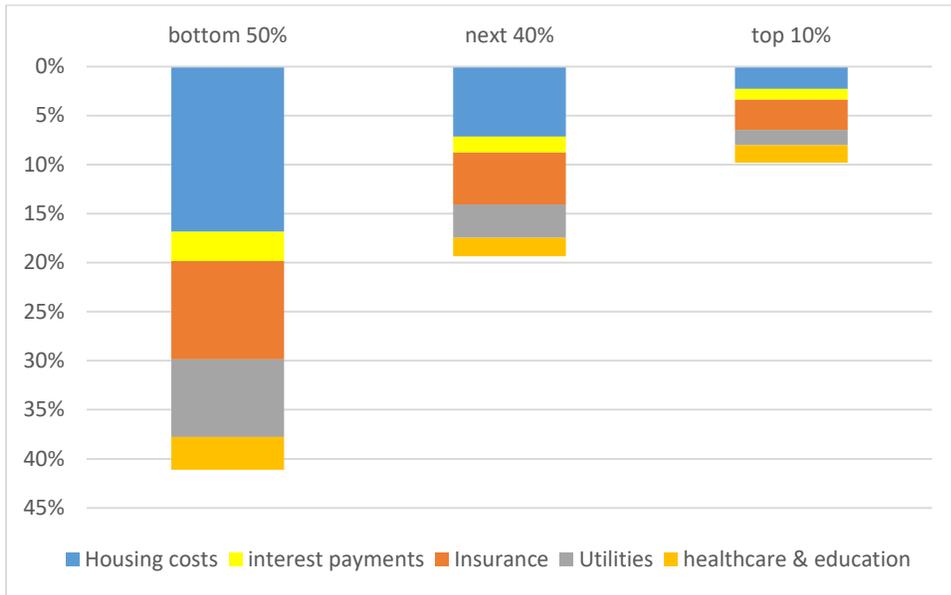
**1998:**



**2007:**

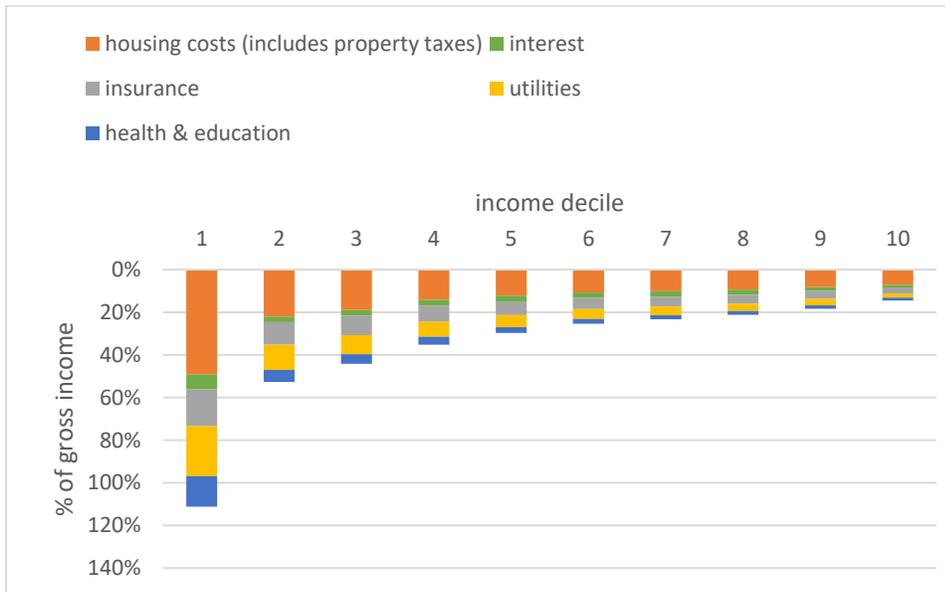


**2016:**



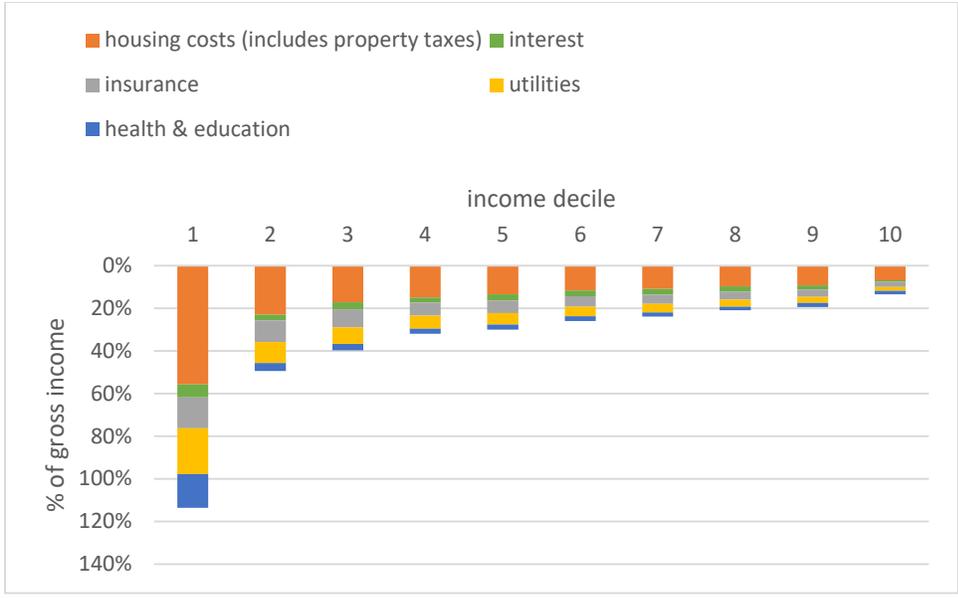
**Figure D.3. Deductions from gross income in percentage terms by income decile: 1998, 2007 and 2016 (income decile 1=poorest, 10=richest)**

**1998:**

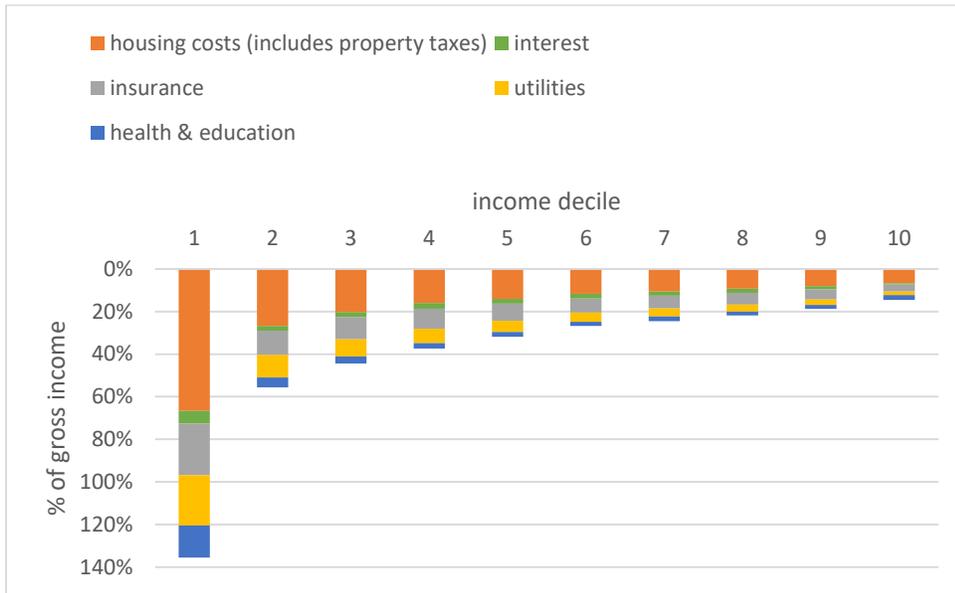


**2007:**

Polarization in America, May 30, 2019, Hudson version



2016:



See for instance <https://www.governing.com/gov-data/economy-finance/housing-affordability-by-city-income-rental-costs.html>, Housing Affordability Burden For U.S. Cities, and Shawn M. Carter, “The top 10 US cities where rents have increased the most,” CNBC, , January 4, 2019 <https://www.cnbc.com/2019/01/04/the-top-10-us-cities-where-rents-have-increased-the-most.html>

At least 33% of income of the bottom 50% goes for rent or housing. For many decades, the rule of thumb was 25% -- not only for rent, but also the guideline for bank lending.

The BLS finds that while incomes have stagnated for the middle class and wage earners, the cost of living has risen, especially for rents.

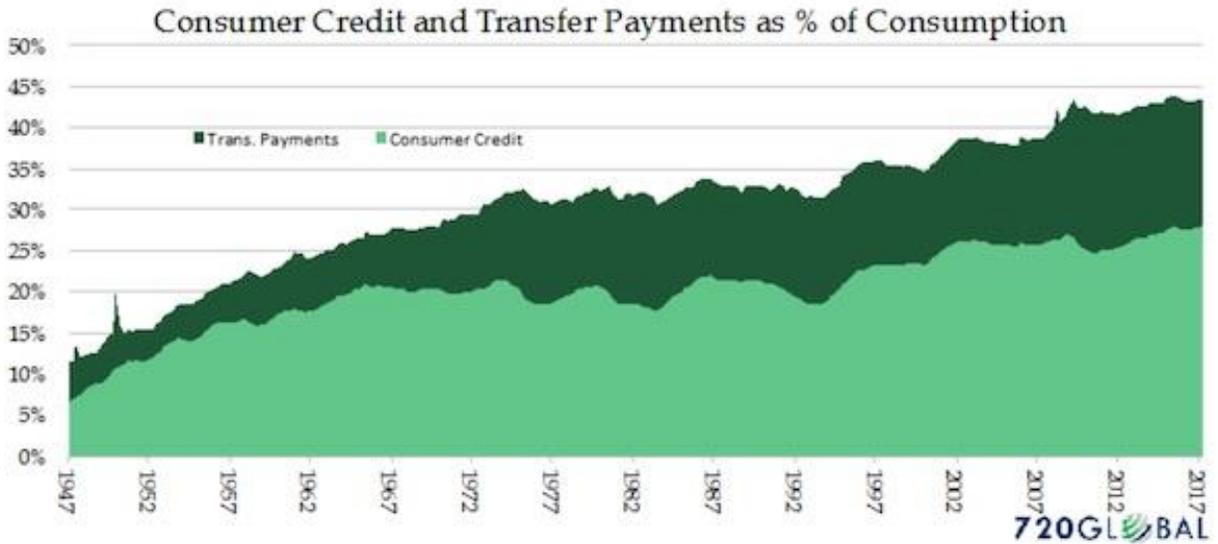
The BLS, Consumer Expenditure Survey Public-Use Microdata 1996-2014 reports that households in the Lower Third spent 40% of their income on housing – and renters nearly half (as of 2014).

The advantage of this series is that in 2004, households at the bottom had \$1,500 left after expenses – but by 2014 they were NEGATIVE \$2,300.

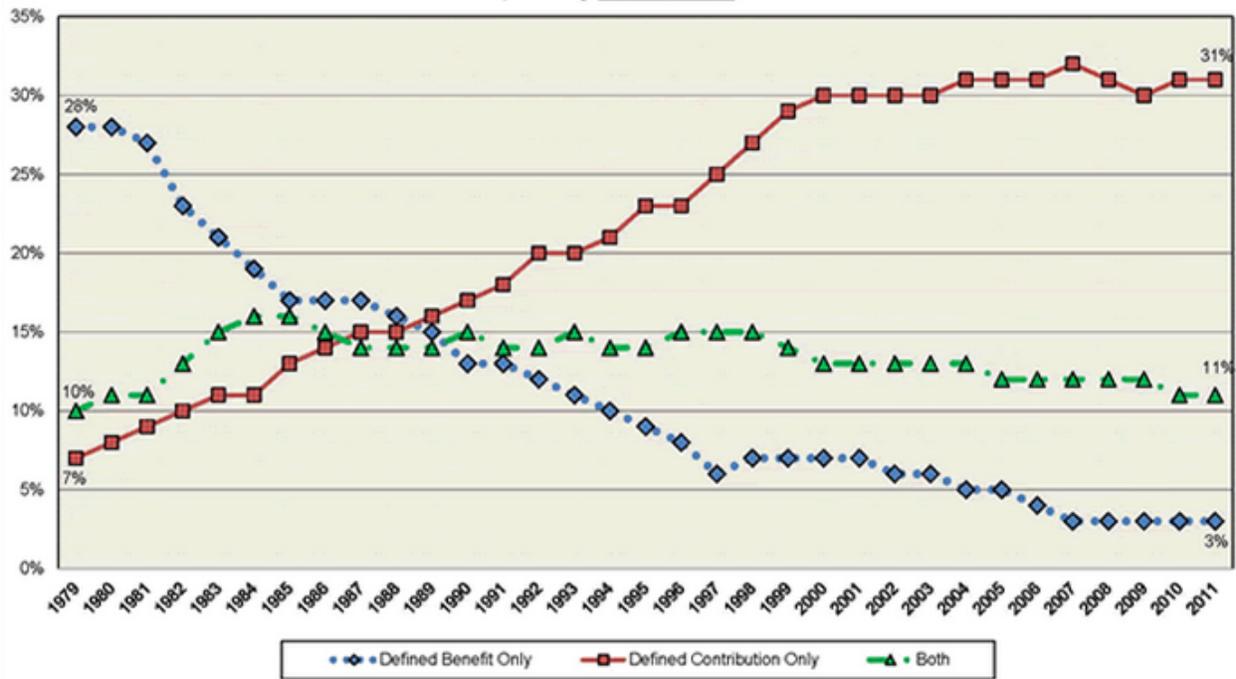
I remember you said there was a problem with the BLS. But that seems like nothing compared to the Fed, unless there’s some explanation for its bizarre charts.

Michael

The only explanation I can think of is most of the bottom 50% are adults living with parents and homeless people living on the streets and under bridges and thus have no housing costs.

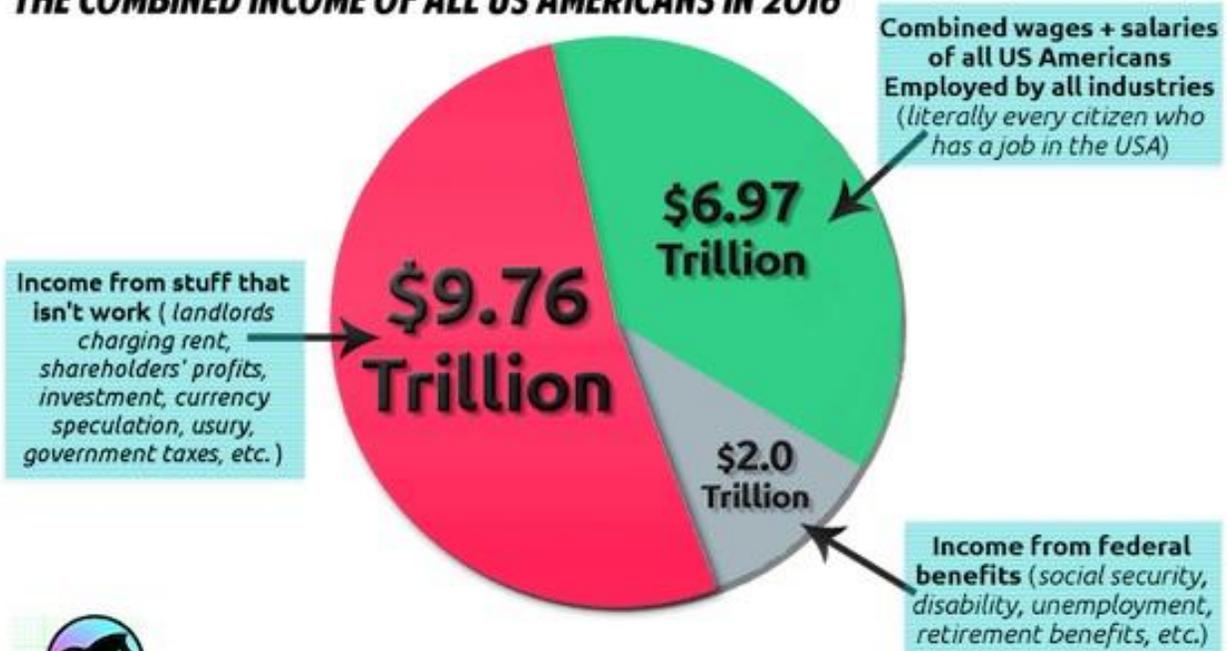


**Figure 1**  
**Private-Sector Workers Participating in an Employment-Based Retirement Plan, by Plan Type, 1979–2011**  
*(Among All Workers)*



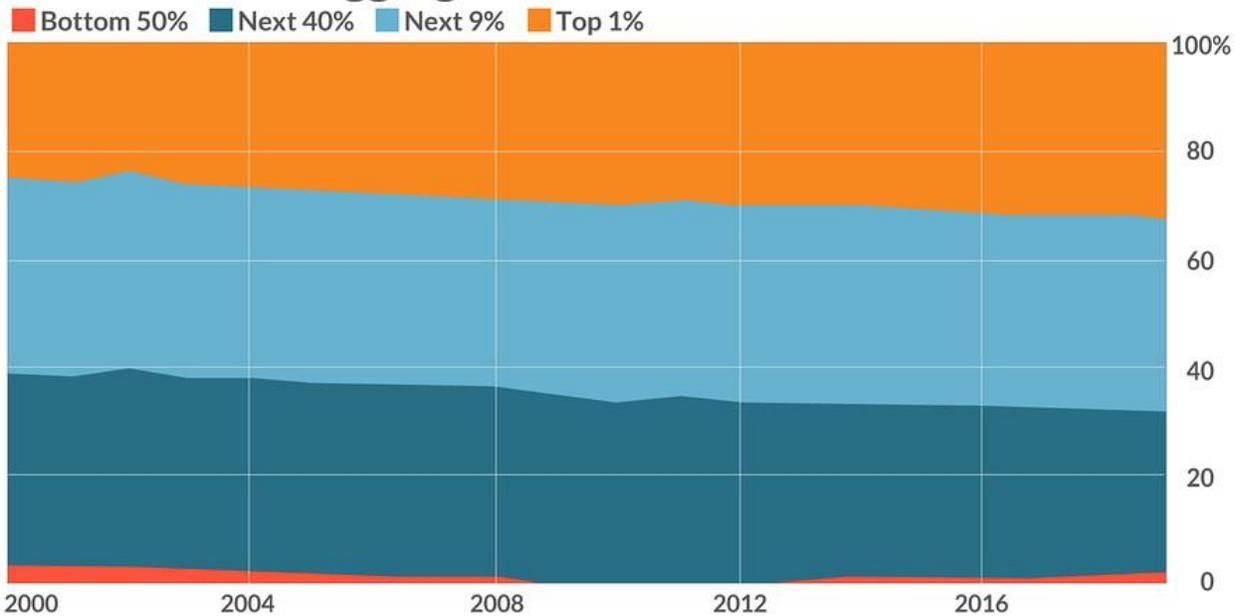
Source: U.S. Department of Labor Form 5500 Summaries 1979–1998, Pension Benefit Guaranty Corporation, Current Population Survey 1999–2011, EBRI estimates 1999–2010.

## THE TOTAL AMERICAN INCOME: THE COMBINED INCOME OF ALL US AMERICANS IN 2016



Sources: Bureau of Labor Statistics, Occupational Employment Survey 2016; US Federal Reserve Macroeconomic Accounts; [www.johnlaurits.com](http://www.johnlaurits.com)

## Distribution of aggregate household wealth



Source: Deutsche Bank Research